

ORIGINAL

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION
RECEIVED

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2005 OCT 11 P 4: 00

AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, FOR
APPROVALS ASSOCIATED WITH A
PROPOSED TRANSACTION WITH MARICOPA
COUNTY MUNICIPAL WATER
CONSERVATION DISTRICT NUMBER ONE TO
ALLOW THE CONSTRUCTION OF A SURFACE
WATER TREATMENT FACILITY KNOWN AS
THE WHITE TANKS PROJECT

DOCKET NO. W-01303A-05-0718

APPLICATION OF ARIZONA-
AMERICAN WATER COMPANY

I. INTRODUCTION

As more fully set forth below, Arizona-American Water Company ("Arizona-American" or the "Company") hereby files for certain approvals associated with a proposed transaction with the Maricopa County Municipal Water Conservation District Number One ("MWD"). Arizona-American and MWD have executed a Memorandum of Understanding ("MOU"). The MOU outlines the basic framework under which MWD will finance, build, and own the White Tanks Plant, Arizona-American will obtain treatment services through a long-term capital lease with MWD, and an Arizona-American affiliate will operate the plant through a Operation and Maintenance Agreement with MWD.

The requested approvals are in the public interest because the MOU and associated agreements, including the capital lease, will make possible:

- Construction of a regional surface-water treatment facility known as the White Tanks Plant, to be owned and operated by MWD;

1 Attached to this application is the *Report of Arizona-American Water Company: White*
2 *Tanks Plant - Capital Lease with Maricopa Water District* ("White Tanks Report"). The White
3 Tanks Report was written on behalf of the Company by Keith R. Larson, James M. Kalinovich,
4 Ray L. Jones, and Thomas M. Broderick. As more fully discussed below, in order to expedite
5 the approval process, the Company proposes to make these individuals available as a witness
6 panel in the hearing on this application. They will jointly sponsor the White Tanks Report and
7 answer questions. The Company also expects to call one or more witnesses on behalf of MWD
8 to answer any questions concerning MWD and its participation in the White Tanks Plant.

9 **II. BACKGROUND**

10 Arizona-American is a public service corporation engaged in providing water and
11 wastewater utility services in portions of Maricopa, Mohave, and Santa Cruz Counties, Arizona,
12 pursuant to various certificates of public convenience and necessity granted by the Arizona
13 Corporation Commission (the "Commission") to Arizona-American and its predecessors in
14 interest. The Company presently provides utility service to approximately 97,000 water
15 customers and 47,000 sewer customers in Arizona and is Arizona's largest investor-owned water
16 and wastewater utility. Arizona-American's Agua Fria District is located in the rapidly
17 developing western Phoenix suburbs (generally north of I-10, between the White Tank
18 Mountains and the 101 Expressway), where the Company currently has about 25,000 water
19 customers and is adding approximately 4,000 new water customers per year.

20 The Company's central business office is located at 19820 North Seventh Street, Suite
21 201, Phoenix, Arizona 85024, and its telephone number is (623) 445-2400. The person
22 responsible for overseeing and directing the conduct of this application is Thomas M. Broderick.
23 Mr. Broderick is American Water's Manager, Rates and Regulations, Western Region. Mr.
24 Broderick works at the above address. His telephone number is (623) 445-2420 and his
25 telecopier number is (623) 445-2454. All discovery, data requests and other requests for
26 information concerning this Application should be directed to Mr. Broderick, with a copy to
27 undersigned counsel for the Company.

1 Arizona-American currently is capitalized with 36.7 % equity and 63.3% long-term debt.
2 Attached as Schedule A is a copy of Arizona-American's September 2005 Balance Sheet.

3 As discussed in Section C of the White Tanks Report, Arizona-American proposes to
4 borrow funds, in the form of a capital lease, from MWD. Arizona-American forecasts the
5 amount of the lease obligation associated with Phase 1A to be \$37,413,874. The actual amount
6 will not be known until after MWD's financing closes and construction of the White Tanks Plant
7 is complete.

8 **III. THE WHITE TANKS PLANT**

9 In Section A of the White Tanks Report, Arizona-American discusses the need for the
10 plant, provides background on the plant, and discusses the MOU between Arizona-American and
11 MWD that will serve as the framework for the transaction where MWD will finance, build, and
12 own the White Tanks Plant, and Arizona-American will lease treatment capacity.

13 Over the last 50 years, the West Valley has developed largely based on groundwater
14 resources. As a result, groundwater overdraft and depletion in the area has been severe.
15 Arizona-American and other entities serving the West Valley have access to Colorado River
16 water delivered through canals and other facilities owned by the Central Arizona Project
17 ("CAP"). However, treatment is required for this water to meet drinking-water standards.

18 In 1997, a number of western Maricopa County municipalities and private water
19 companies holding CAP water contracts formed WESTCAPS to develop cooperative regional
20 solutions for use of the region's CAP water allocations and other renewable water supplies.
21 WESTCAPS determined that regional planning was needed to develop the best strategy to
22 supply the water needed to support the expected growth in the West Valley.

23 In April 2001, WESTCAPS released its Regional Water Supply Plan. Groundwater
24 modeling studies conducted by ADWR and by the Bureau of Reclamation as part of the
25 WESTCAPS study warned that continued reliance on groundwater to support new development
26 would cause unacceptable groundwater level declines and accelerate land-subsidence problems.

1 The Regional Water Supply Plan concluded that the area's water suppliers should maximize their
2 use of CAP and other surface water resources.

3 To treat CAP water, WESTCAPS recommended the construction of two regional
4 treatment facilities, including one at Cactus and Perryville Road, on the Beardsley canal. This is
5 the proposed site of MWD's regional treatment facility, the White Tanks Plant.¹

6 Arizona-American holds a CAP-water subcontract for 11,093 acre-feet per year, which
7 will require treatment before it can be delivered to its Agua Fria customers. In addition,
8 Arizona-American and MWD have an agreement whereby MWD will provide Agua Fria surface
9 water to Arizona-American. This water will be available for treatment and delivery to Arizona-
10 American's Agua Fria customers residing within the MWD area. Arizona-American estimates
11 that this agreement will result in up to 21,000 acre-feet of additional surface water being
12 available annually for direct treatment and delivery at buildout of the Agua Fria District.

13 In 2002, Arizona-American began moving forward with the regional treatment plant
14 concept by purchasing a 45-acre parcel of land at the site identified in the WESTCAPS Regional
15 Water Supply Plan. At that time, Arizona-American believed that it could obtain financing to
16 design, build, and operate a large regional treatment facility.

17 In 2003, Arizona-American signed a contract for plant design and construction with the
18 Joint Venture of Black and Veatch (design and engineering), and Western Summit Constructors,
19 Inc. (construction). As designed, the White Tanks Plant will be constructed in phases. The
20 capacity of the Phase Ia plant is 13.5 mgd and is expandable to 20 mgd (Phase Ib) with the
21 addition of one treatment unit train. Three additional phases (20 mgd each) will eventually be
22 added, depending on the rate of development in the region, for a total treatment capacity of 80
23 mgd. As of October 2005, the design and permitting (through Maricopa County and other
24 agencies), of the Phase I plant is 95 percent complete.

¹ The City of Peoria will likely build the second regional treatment facility.

1 In 2004, MWD approached Arizona-American and inquired about obtaining an
2 ownership interest in the White Tanks Plant. Sometime after MWD approached Arizona-
3 American, the Company learned that it would not be able to obtain financing to build the White
4 Tanks Plant as originally configured. Negotiations then shifted toward a new scenario, where
5 MWD would take responsibility for financing, building, and owning the White Tanks Plant, with
6 Arizona-American entitled to lease the majority of the treatment capacity.

7 The negotiations between MWD and Arizona-American ultimately led to the execution
8 of the MOU. A copy of the MOU is Attachment A to the White Tanks Report. The MOU
9 outlines the basic framework under which MWD will finance, build, and own the White Tanks
10 Plant, Arizona-American will obtain treatment services through a long-term capital lease with
11 MWD, and an Arizona-American affiliate will operate the plant through an Operation and
12 Maintenance Agreement with MWD.

13 To offset the delay caused by the extended negotiations, the need for regulatory approval,
14 and MWD's public-bidding requirement—MWD will supply water from existing MWD
15 irrigation wells to Arizona-American's Agua Fria system until the plant is on-line in mid 2008.
16 Arizona-American will evaluate a number of existing MWD wells to select wells that produce
17 water that is acceptable, both in quantity and quality. Arizona-American will be responsible for
18 chlorinating the water and paying for the associated operating costs. This is a much lower cost
19 option than if Arizona-American had to construct additional wells during this period—wells of
20 unknown quality and yield.

21 Highlights of the MOU follow:

- 22 • Implementing the MOU requires Commission approval, which will be needed by the end
23 of the first quarter of 2006 if the mid-2008 completion date is to be met.
- 24 • MWD will purchase the plant site and plant design documents from Arizona-American
25 following Commission approval.
- 26 • MWD will then competitively bid the construction of the plant in the first quarter of
27 2006.

- 1 • MWD will award the construction in the second quarter of 2006, contingent on
2 Commission approval.
- 3 • MWD's financing will close shortly after Commission approval.
- 4 • MWD will purchase from Arizona-American the land where the White Tanks Plant will
5 be sited.
- 6 • MWD will purchase a recently constructed trunk pipeline from Arizona-American, which
7 will be used to deliver treated water from the plant to the Arizona-American, City of
8 Goodyear, and Arizona Water Company water distribution systems.
- 9 • Construction will commence shortly after financing closes.
- 10 • Arizona-American will execute a 40-year capital lease for 7.5 mgd treatment capacity
11 with MWD.
- 12 • The City of Goodyear and Arizona Water Company are expected to contract for the
13 remaining 6 mgd of treatment capacity.
- 14 • The costs of retrofitting and connecting the interim well supplies to the Arizona-
15 American system will be included in the 40-year capital lease.
- 16 • MWD will purchase the design documents for a yet to be constructed segment of the
17 trunk pipeline. MWD will competitively bid the construction of this pipeline segment in
18 conjunction with the plant construction.
- 19 • A proportionate share of the capital cost of treated water conveyance capacity in these
20 pipelines will be part of the capital lease between Arizona-American and MWD.
- 21 • Approximately 80 percent of Arizona-American Agua Fria customers will reside within
22 the Maricopa Water District. MWD will provide landowners within the MWD District
23 with the economic benefits of the District's ownership of the White Tanks Regional
24 Water Treatment Plant. Annual credits on Arizona-American water bills as well as other
25 mechanisms may be used to convey benefits to landowners within MWD.

- The capital lease interest rate is set at 275 basis points over the long-term treasury-bond rate. Assuming a 30-year treasury-bond rate of 4.25%, this would result in a 7% interest rate.

As mentioned above, Arizona-American intends to lease 7.5 mgd of the initial 13.5 mgd capacity of the plant. Discussions are underway between MWD, the City of the Goodyear, and the Arizona Water Company (White Tanks Division) regarding these entities contracting with MWD for the other six mgd of plant capacity. Each of these entities is a WESTCAPS member. It is expected that these and other entities will contract for more capacity as MWD adds additional phases to the Plant. Multiple participation allows construction of a large regional plant on one site, so that the per-gallon cost of treatment is less than if each entity built and owned its own treatment facility.

IV. THE CAPITAL LEASE

Section II of the White Tanks Report discusses the proposed capital lease and its terms. Also discussed are why the transaction must be structured as a capital lease and the required accounting for a capital lease. Finally, the White Tanks Report explains how the capital lease will affect Arizona-American's capital structure.

Under Financial Accounting Standard ("FAS") 13, a lease is classified as a capital lease if it meets one or more of the following criteria:²

- a. The lease transfers ownership at the end of the lease term.
- b. The lease contains a bargain purchase option.
- c. The lease term is equal to 75% or more of the estimated useful life of the leased property.
- d. The present value of the minimum lease payments (excluding executory costs such as taxes, maintenance, insurance, etc.) is equal to or greater than 90% of the fair value of the leased property.

² FAS 13, par. 7.

1 The MWD transaction will satisfy both subparagraphs c) and d). The expected term of 40 years
2 will slightly exceed the estimated useful life of the leased property. Also, the present value of
3 the minimum lease payments is expected to equal the fair value of Arizona-American's share of
4 the leased property. Therefore, the transaction will be treated as a capital lease.

5 NARUC Accounting Instruction 22 basically states that regulatory accounting for a
6 capital lease follows financial accounting. Capital leases are recorded as an obligation and an
7 asset equal to the present value of minimum lease payments during the term of the lease
8 (excluding executory costs), not to exceed the fair value of the leased property. The asset is
9 depreciated according to the lessee's normal depreciation policy, except the period of
10 depreciation is the lesser of the lease term (lease term shall include the period covered by a
11 bargain renewal option) or the assets useful life. Operation and maintenance expense is a normal
12 expense item.

13 This accounting treatment contrasts to that for an operating lease, where the entire lease
14 payment is an expense.

15 As discussed in Section II of the White Tanks Report, Arizona-American will finance the
16 leased asset with a combination of 40% equity and 60% debt. American Water Works will inject
17 the required equity and the capital lease debt rate will be set at 275 basis points over the 30-year
18 Treasury bond rate (according to terms of lease). At present rates (4.25%) this would be
19 approximately 7.0%. The actual rate will be set when MWD's financing closes, which will be
20 shortly after the Commission's approval of this application. Because this debt will refinance a
21 certain amount of short-term borrowings from American Water Capital Corp, we anticipate a
22 slight increase in Arizona-American's overall cost of capital, which will be addressed in the
23 Company's 2008 filing discussed below. This slight increase in debt costs reflects higher
24 interest rates on long-term, fixed-rate third party debt versus short-term variable rate American
25 Water Capital Corp debt.

1 **V. COMPARISON TO ALTERNATIVES**

2 Section III of the White Tanks Report discusses two alternatives to the proposed
3 transactions with MWD. One is a business-as-usual case, where the Company would continue to
4 drill wells to meet the needs of new customers. The second alternative case assumes that the
5 Company were to build a treatment facility to meet just its own needs. This would be a 13.5
6 mgd facility at the same location, constructed in two 6.25 mgd phases.

7 The well-drilling option would cost customers slightly more than the MWD capital lease.
8 However, the well-drilling option would be significantly riskier, because it is becoming more
9 difficult to drill wells that yield good quantities of high quality water, particularly in the southern
10 area of the Company's Agua Fria District. Further, the well-drilling option would further lower
11 the water table and exacerbate subsidence problems. Finally, no potential credits would be
12 available from MWD to Arizona-American customers who reside in the MWD territory. For
13 these reasons, the Company does not believe the well-drilling option should be pursued.

14 The standalone treatment facility option would be consistent with public policy, but
15 would be more expensive than leasing treatment capacity at MWD's White Tanks Plant because
16 of lost economies of scale. Also, no potential credits would be available from MWD to Arizona-
17 American customers who reside in the MWD territory. For these reasons, the Company does not
18 believe the standalone option should be pursued.

19 **VI. PROPOSED PROCEDURE**

20 Arizona-American requests that the Commission approve the following rate-making
21 procedure for the Company to recover the costs associated with entering into the MWD capital
22 lease. This procedure is largely modeled on the Commission's ACRM process to recover the
23 extraordinary costs associated with arsenic remediation.

24 **A. Initial Approvals**

25 **1. Transaction Approval**

26 MWD's construction of the White Tanks Plant and its provision interim water supplies to
27 Arizona-American are both contingent upon Arizona-American's receipt of the requested

1 approvals from the Commission. To satisfy demands in each of Arizona-American's rapidly
2 growing Agua Fria District, the Town of Goodyear, and Arizona Water's White Tanks service
3 territory, MWD is striving to put the White Tanks Plant in service by summer 2008.

4 Construction of the White Tanks Plant will take approximately two year. To meet this goal, a
5 construction contract must be awarded (through competitive bidding) by the second quarter of
6 2006. This will require Commission approval of the transaction by the end of the March 2006.

7 The Company proposes, in lieu of direct testimony, to make the authors of the White
8 Tanks Report available as a witness panel in the hearing on this application to sponsor the White
9 Tanks Report and answer any questions about it. The Company also expects to call one or more
10 witnesses on behalf of MWD to answer any questions concerning MWD and its participation in
11 the White Tanks Plant.

12 **2. Revised Hook-up Fees Set**

13 As discussed below, Arizona-American is asking to revise its existing water hook-up fees
14 for the Agua Fria Water District to raise additional funds to reduce the rate impact of the White
15 Tanks Capital Lease. Having developers fund the cost of water treatment needed to serve future
16 development is consistent with cost-causation principles, with Commission precedent, and with
17 the fees charged by municipal water providers to fund new infrastructure. Arizona-American is
18 asking that the revised hook-up fees be approved as soon as possible in this case, and no later
19 than the second quarter of 2006. Arizona-American's analysis of the required amount of the
20 revised hook-up fee is provided in Section IV(C) of the White Tanks Report.

21 **B. 2007 Agua Fria Rate Case**

22 Early in the second quarter of 2007, Arizona-American will file a rate case using a 2006
23 test year for its Agua Fria Water District. Based on this filing, the Commission will determine
24 the cost of service for the Agua Fria District, including rate base and authorized return on equity.
25 The Company projects the Order will be issued sometime in the second quarter of 2008.

1 **C. 2008 White Tanks Filing (Step One)**

2 To recover its extraordinary costs associated with the White Tanks Plant, Arizona-
3 American proposes a procedure similar to that approved by the Commission to deal with the
4 extraordinary capital expenditures required to comply with the revised federal arsenic standards
5 for drinking water. Like a Step One ACRM filing, once the White Tanks Plant is complete and
6 providing service, the Company will make a filing to determine the monthly rates necessary to
7 recover the revenue requirement associated with the associated MWD Capital Lease, including
8 return on rate base, depreciation, and fixed O&M. This revenue requirement would be based on
9 the revenue requirement components that were determined, roughly contemporaneously, in the
10 2007 general rate filing for the Agua Fria District. An adjustment would need to be made for the
11 slightly increased cost of capital associated with carrying the debt cost associated with the White
12 Tanks Plant lease.

13 The White Tanks Plant rate base will be offset by the cumulative contributions received
14 from the revised hook-up fees, discussed below. As discussed below, because of the funds
15 generated by the hook-up fees, Arizona-American expects that the amount of the surcharge will
16 be relatively small.³

17 The final component of this filing will be to reset the hook-up fee. In support of this
18 component, Arizona-American will file schedules of projected customer additions by meter size
19 along with anticipated capital projects needed to satisfy this new demand. These projects will
20 include Arizona-American's share of Phase 1B of the White Tanks Plant and will likely also
21 include future phases of the White Tanks Plant.

22 **D. Step Three Filing**

23 Like an ACRM Step Three filing, approximately one year after the White Tanks Plant
24 begins operation, Arizona-American will make a filing to begin recovery through a surcharge of
25 the variable O&M costs associated with its share of the White Tanks Plant capacity. Examples

³ See Attachment E to the White Tanks Report.

1 of these type of costs are chemicals, electric power, residuals, and maintenance. These costs are
2 projected to be approximately \$70,000 per mgd/year. First-year variable costs would be deferred
3 and recovered along with second-year variable costs.

4 **E. Additional Filings**

5 Arizona-American plans to lease capacity in additional phases of the White Tanks Plant.
6 The Company would make additional filings associated with a general rate case to adjust for the
7 rate impacts of these capacity additions.

8 **VII. PROPOSED RATEMAKING**

9 Capital leases are recorded as an obligation and an asset equal to the present value of
10 minimum lease payments during the term of the lease (excluding executory costs), not to exceed
11 the fair value of the leased property. Mr. Broderick discusses the details of the proposed
12 ratemaking in Section IV of the attached White Tanks Report.

13 Attachment D to the White Tanks Report is a schedule showing the projected rate impact
14 of the MWD capital lease when the White Tanks plant becomes operational (assumes July 2008).
15 Attachment D shows that the full-year revenue requirement associated with Phase 1A of the
16 MWD capital lease would be approximately \$5 million. This revenue requirement would require
17 a rate increase of approximately \$ 10.00/customer/month.

18 **VIII. REVISED HOOK-UP FEES**

19 As further discussed in Section IV of the White Tanks Report, Arizona-American
20 currently collects two water-related hook-up fees in the Agua Fria District. The first is the
21 Central Arizona Project Hook-up Fee ("CAP Hook-up Fee"), which was intended to recover the
22 cost of acquiring and holding CAP water for the Company's Agua Fria customers. Developers
23 pay a one-time charge of \$ 257.00 per residential building, and \$150 per equivalent residential
24 unit ("ERU"), based on meter size, for commercial buildings. Funds generated by this fee are
25 treated as revenue and reduce the company's unrecovered costs of acquiring CAP water to serve
26 the Agua Fria District. The Company estimates that CAP Hook-up Fee will have fully funded its

1 intended purpose by the end of the second quarter, 2006, when, as required by the Order, it
2 would end.

3 Arizona-American also charges a Water Facilities Hook-up Fee in its Agua Fria District.
4 This fee is intended to offset the costs of new water facilities needed to serve new customers,
5 including new treatment facilities. The fee is based on based on meter size and starts at \$1,150
6 for a 5/8 x 3/4-inch meter. This is a one-time fee per service connection or residential lot within
7 a platted subdivision. Funds generated by this fee are treated as contributions in aid of
8 construction ("CIAC"). CIAC funds are revenue neutral and directly offset rate base. To date
9 the funds raised by this hook-up fee have funded construction of a number of water infrastructure
10 projects.

11 To reduce the rate impact of the MWD Capital Lease, Arizona-American proposes to
12 discontinue the Water Facilities Hook-up Fee, and extend the CAP Hook-up Fee, with
13 modifications. Developer currently paying approximately \$1,950 for a 3/4 inch meter connection
14 would pay \$2,700. This proposal would largely offset the rate increase needed to recover the
15 revenue requirement and other costs associated with the MWD Capital Lease.

16 Arizona-American proposes that funds from the revised CAP Hook-up Fee be treated as
17 CIAC, but booked separately to be accumulated and used to offset the ratebase increase
18 attributable to the MWD Capital Lease. As shown on Attachment E to the White Tanks Report,
19 this would decrease the revenue requirement associated with the MWD capital lease to
20 approximately \$3 million , and the associated rate increase would be reduced to approximately
21 \$6.00/per customer/month.

22 The proposed adjusted CAP hook-up fees are reasonable. Existing customers will benefit
23 from receiving treated CAP water and reduced groundwater usage, so they should bear a portion
24 of the White Tanks Plant's cost. However, because much of the capacity will be used to satisfy
25 future growth, using hook-up fees to pay for a large part of the White Tanks Plant is also
26 appropriate. Finally, the Company's hook-up fees have long lagged those charged by municipal

1 water suppliers. For example, in the City of Peoria, the water hook-up fee for ¾ and one-inch
2 meters is \$3,497.

3 **IX. CUSTOMER BENEFITS**

4 There are a number of important benefits to the proposed transaction with MWD and the
5 associated approvals:

- 6 • The transaction will make possible the construction of a regional surface-water
7 treatment facility known as the White Tanks Plant, to be owned and operated by
8 MWD;
- 9 • Arizona-American will be able to use its share of the treatment capacity at the White
10 Tanks Plant to treat its entitlement to Colorado River water delivered through
11 facilities of the Central Arizona Project;
- 12 • Consistent with state, local, and Commission policy, the transaction will preserve
13 groundwater resources throughout the Company's Agua Fria District by significantly
14 reducing anticipated groundwater usage;
- 15 • MWD will connect three mgd of well capacity to the Arizona-American system by
16 the summer of 2007 to bridge the gap in production capacity until the plant becomes
17 operational in 2008;
- 18 • The transaction is the low-cost option to meet future water needs for the Company's
19 Agua Fria customers; and
- 20 • With the hook-up fee adjustments, there will be only a moderate rate increase
21 associated with entering into the proposed transaction with MWD.

22 **X. REQUESTED APPROVALS**

23 Arizona-American is asking for the following specific regulatory approvals from the
24 Commission as part of its order in this proceeding:

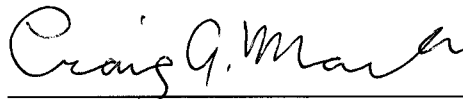
- 25 • Authorize Arizona-American Water Company under A.R.S. § 40-301 *et. seq* to issue
26 an evidence of indebtedness in an amount equal to the capital lease asset and
27 determined consistent with the methodology set forth in Attachment B;

- Authorize Arizona-American Water Company under A.R.S. § 40-285 to transfer the Pipeline Main and other assets to Maricopa County Municipal Water Conservation District Number One;
- Find that it is prudent for Arizona-American Water Company to enter into the agreements contemplated in the MOU, including the proposed capital lease with Maricopa County Municipal Water Conservation District Number One;
- Approve the regulatory process set forth in Section IVA of the White Tanks Report;
- Authorize the ratemaking treatment set in Section IVB of the White Tanks Report for the proposed capital lease and associated documents between Arizona-American Water Company and The Maricopa County Municipal Water Conservation District Number One; and
- Authorize, as set forth in Section IVB of the White Tanks Report, Arizona-American Water Company to implement revised CAP hook-up fees to reduce the rate impact of the proposed capital lease.

CONCLUSION

For all the reasons set forth above and in the attached White Tanks Report, Arizona-American Water Company asks the Commission to provide the requested authorizations.

RESPECTFULLY SUBMITTED on October 11, 2005.



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Phoenix, Arizona 85024

Original and 13 copies filed
on October 11, 2005, with:

Docket Control

1 Arizona Corporation Commission
2 1200 West Washington
3 Phoenix, Arizona 85007
4

5 Copies of the foregoing mailed
6 on October 11, 2005, to:
7

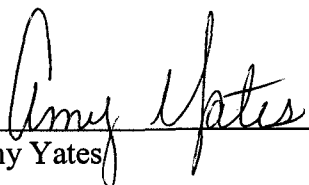
8 Hearing Division
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33
34
35 By: 
36 Amy Yates

Schedule A

ARIZONA AMERICAN WATER COMPANY				
BALANCE SHEET				
ASSETS			September	
			2005	2004
Utility Plant - at original cost			479,631,256	438,643,884
Construction Work in Progress			55,618,010	21,002,746
Accumulated Depreciation			(103,218,667)	(90,298,572)
Utility Plant Acquisition Adjustments			30,568,331	31,568,441
			462,598,930	400,916,499
Non-Utility Property			111,151	111,151
Other investments			37,334,706	37,116,498
Current Assets				
	Cash and Cash Equivalents		1,357,122	1,355,014
	Temp Invest - at cost plus accr int		-	-
	Customer Accounts Receivable		4,062,536	3,498,000
	Allowance for Uncollectible Accounts		(300,646)	(56,319)
	Unbilled Revenues		2,310,650	1,915,661
	FIT Refund Due from Assoc. Companies		3,355,056	1,430,745
	Miscellaneous Receivables		5,516,625	6,144,168
	Materials and Supplies - at Average Cost		332,545	344,013
	Other		1,082,105	829,971
			17,715,993	15,461,253
Regulatory and Other Long-Term Assets				
	Debt Expense		442,810	488,142
	Expense of Rate Proceedings		465,209	414,491
	Preliminary Survey and Investigation		542,499	635,531
	Regulatory Assets - Income Tax Recoverable Through Rates		1,355,414	962,961
	Other		7,135,888	4,723,329
			9,941,820	7,224,454
Total Assets			\$527,702,600	\$460,829,855
CAPITAL AND LIABILITIES				
Common Stock			522,880	522,880
Paid in Capital			114,468,228	114,468,228
Retained Earnings			429,263	1,273,653
	Total Equity		115,420,371	116,264,761
Long-Term Debt			198,757,395	173,772,252
	Total Capitalization		314,177,766	290,037,013
Current Liabilities				
	Bank Debt		15,127,255	17,382,153

	Current Portion of LTD			16,050	22,205
	Accounts Payable			11,500,723	3,964,150
	Taxes Accrued, including Federal Income			1,639,659	1,975,137
	Interest Accrued			7,287,250	7,011,828
	Customer Deposits			59,003	53,069
	Other			12,314,056	11,515,153
				47,943,996	41,923,695
	Regulatory and Other Long-Term Liabilities				
	Customer Advances for Construction			137,958,349	112,546,641
	Deferred Income Taxes			5,863,156	3,813,984
	Deferred Investment Tax Credits			68,476	72,196
	Regulatory Liability - Income Taxes Refundable Through Rates			252,726	296,934
	Other			3,170,827	2,398,388
				147,313,534	119,128,143
	Contributions in Aid of Construction			18,267,301	9,741,003
Total Liabilities				\$527,702,597	\$460,829,854

**Arizona-American Water Company
White Tanks Water Treatment Facility
Capital Lease with Maricopa Water District
Docket No. W-01303A-05-_____**

**Report of Arizona-American Water Company
White Tanks Water Treatment Facility
Capital Lease with Maricopa Water District**

**Keith R. Larson
Water Resources Director, Western Region, American Water
James M. Kalinovich
Vice President & Treasurer, American Water
Ray L. Jones
Principal, ARICOR Water Solutions
Thomas M. Broderick
Manager Rate & Regulatory Affairs, American Water**

**Report of Arizona-American Water Company
White Tanks Water Treatment Facility
Capital Lease with Maricopa Water District**

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**Report of Arizona-American Water Company
White Tanks Water Treatment Facility
Capital Lease with Maricopa Water District**

EXECUTIVE SUMMARY

Arizona-American Water Company (“Arizona-American” or the “Company”) is Arizona’s largest investor-owned water utility. Arizona-American is a wholly owned subsidiary of American Water Works Company, Inc. (“American Water”). To satisfy its customers’ needs for adequate drinking water and to reduce demands on the aquifer, Arizona-American plans, like many Arizona water providers, to utilize Colorado River water supplies delivered over the facilities of the Central Arizona Project (“CAP Water”). However, before this water can be delivered to customers it must be treated to satisfy state and federal drinking water standards.

In Section I of this Report, Keith Larson, American Water’s Water Resources Director, Western Region, discusses how Arizona-American proposes to obtain treatment for its CAP Water share. Arizona-American has entered into a Memorandum of Understanding with the Maricopa County Municipal Water Conservation District Number One (“MWD”), whereby MWD will build and own a regional water treatment facility known as the White Tanks Plant. The White Tanks Plant is the result of a regional water resource study, which identified the need for and the location of the facility. Arizona-American intends to contract for 7.5 million gallons per day (“mgd”) of Phase 1A (13.5 mgd) and 4.0 mgd of Phase 1B (6.5 mgd) of the White Tanks Plant capacity. The White Tanks Plant will be ultimately expandable in three additional phases of 20 mgd, each up to a total capacity of 80 mgd.

Plant design is essentially complete. Construction of Phase 1A of the White Tanks Plant will take approximately 24 months. Therefore, construction must begin in the second quarter of 2006 for the White Tanks Plant to be available to treat CAP water by the summer of 2008. However, Arizona-American will need additional water resources to meet the expected water demands of its Agua Fria customers by the summer of 2007. MWD has committed to supply interim water to Arizona-American until the White Tanks Plant is operational in 2008.

For construction of the White Tanks Plant to go forward, and for MWD to supply interim water to Arizona-American, several specific Commission approvals are necessary.¹ These approvals will be needed by early spring 2006, so that construction can begin in time for the White Tanks Plant to enter service to satisfy summer 2008 demands. If it appears that the plant will not be available by 2008, Arizona-American will need to immediately begin developing additional wells to meet summer-2008 demand.

In Section II of the Report, James M. Kalinovich, American Water's Vice President and Treasurer, discusses American Water's appropriate accounting for the transaction between Arizona-American and MWD. Under Financial Accounting Standard 13, the transaction will be treated as a capital lease. An asset and a matching liability will be recorded on Arizona-American's books equal to the fair market value of the lease asset, with depreciation taken over the useful life of the asset. Regulatory accounting should also follow these requirements.

In Section III of this Report, Ray L. Jones of ARICOR Water Solutions discusses a financial analysis where he compared Arizona-American's participation in MWD's White Tanks Plant with two other options. One option was business-as-usual, where the Company would continue to rely on existing and new wells to meet its customers' drinking-water requirements. The expected cost of this option was slightly higher than the White Tanks Plant option, but pursuing the business-as-usual option would be contrary to public policy. Public policy is to encourage the use of renewable surface water resources and to discourage groundwater usage, which would increase land subsidence and reduce the water table. The other option would be for Arizona-American to build its own water treatment facility. However, without other partners, this option would be significantly more expensive, because of reduced economies of scale.

As part of his analysis, Mr. Jones also calculates the expected depreciation expense associated with the White Tanks Plant transaction.

¹ Mr. Broderick discusses these specific approvals in Section IVD of the Report.

Finally, in Section IV of the Report, Thomas M. Broderick, American Water's Manager of Rate and Regulatory Affairs, discusses a number of topics. First, he recommends the procedure for the Commission to follow to provide the necessary approvals for Arizona-American's participation in the White Tanks Plant. This procedure is modeled after the ACRM procedure used by the Commission in connection with the large arsenic-remediation investments that many Arizona water utilities must make, including Arizona-American. In this docket, the Commission would provide a number of approvals after its review of this filing, including a determination that it is prudent for the Company to enter into the transaction. Then in early 2007, Arizona-American will file a general rate case for its Agua Fria District. The White Tanks Plant would then enter service sometime in mid 2008. Following the in-service date, Arizona-American would make a Step 1 filing to adjust rates, based on the 2007 rate case, to recover the costs associated with the MWD Capital Lease, including return on rate base, depreciation, and fixed O&M. Finally, after a year's experience with the plant operation, the Company would make a Step 2 filing to begin recovery through a surcharge of the variable O&M costs associated with its share of the White Tanks Plant capacity.

Mr. Broderick next analyzes the expected rate impact of the White Tanks Plant transaction. Arizona-American is currently receiving hook-up fees on new construction to fund the construction of water facilities needed to satisfy increased demands resulting from customer growth. Therefore, hook-up fees will fund part of the transaction. The remaining revenue requirement will be approximately \$5 million, with an average residential customer seeing approximately a \$10/month bill increase.

Mr. Broderick next proposes a slight increase in the current hook-up fees to further offset the rate impact of the proposed transaction. If the base hook-up fee were increased by approximately \$500, the revenue requirement would be reduced to about \$3 million and the corresponding rate increase for the average residential customer would be reduced to about \$6/month.

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Finally, Mr. Broderick discusses the specific regulatory requests needed by Arizona-American for the transaction to proceed.

**Report of Arizona-American Water Company
White Tanks Water Treatment Facility
Capital Lease with Maricopa Water District**

I. THE WHITE TANKS PLANT (Keith R. Larson)

A. Regional Need for Surface Water Treatment Facility

Arizona-American Water Company ("Arizona-American" or the "Company") is Arizona's largest investor-owned water utility. Arizona-American's Agua Fria District is located in the rapidly developing western Phoenix suburbs (generally north of I-10, between the White Tank Mountains and the 101 Expressway), where the Company is adding approximately 4,000 new customer connections per year.

Over the last 50 years, the West Valley has developed largely based on groundwater resources. As a result, groundwater overdraft and depletion in the area has been severe. Arizona-American and other entities serving the West Valley have access to Colorado River water delivered through canals and other facilities owned by the Central Arizona Project ("CAP"). However, treatment is required for this water to meet drinking-water standards.

In 1997, a number of western Maricopa County municipalities and private water companies holding CAP water contracts formed WESTCAPS to develop cooperative regional solutions for use of the region's CAP water allocations and other renewable water supplies. The Maricopa County Municipal Water Conservation District Number One ("MWD"), the West Valley irrigation water supplier that owns and operates the Beardsley Canal, has supported the WESTCAPS effort. This effort was driven by the concerns of ADWR and West Valley water providers about the long-term consequences of providing for continued population growth using groundwater. Continuing to rely on groundwater to support this growth seemed imprudent because of accelerated groundwater level declines, land subsidence, declining well production rates, and the increasing number of wells that could not meet Safe Drinking Water Act standards.

WESTCAPS determined that regional planning was needed to develop the most cost-effective strategy to supply the water needed to support the growth expected in the West Valley.

1 To facilitate the WESTCAPS plan development and the curtailment of groundwater use in the
2 West Valley, ADWR contributed a total of \$200,000 toward the study. The U.S. Bureau of
3 Reclamation also contributed over \$1,000,000 of in-kind services toward the project.

4 In April 2001, WESTCAPS released its Regional Water Supply Plan. Groundwater
5 modeling studies conducted by ADWR and by the Bureau of Reclamation as part of the
6 WESTCAPS study warned that continued reliance on groundwater to support new development
7 will result in long-term groundwater water level declines that approach or exceed the ADWR
8 Assured Water Supply limit of 1000 feet below land surface. This would cause unacceptable
9 groundwater level declines and accelerate land-subsidence problems. The Regional Water
10 Supply Plan concluded that the area's water suppliers should maximize their use of CAP and
11 other surface water resources. To treat that water, WESTCAPS recommended the construction
12 of two regional treatment facilities.

13 One of those treatment facilities has become the White Tanks Regional Water Treatment
14 Facility ("White Tanks Plant").² The WESTCAPS study selected the site of the proposed White
15 Tanks Plant (Cactus and Perryville Road, on the Beardsley canal) because of its location on the
16 canal and its proximity to multiple water provider service areas. The 45-acre plant site can
17 support an ultimate plant capacity of 80 million gallons per day (mgd).

18 Arizona-American's recent experience underscores the need for the White Tanks Plant.
19 Most recently constructed wells within the Agua Fria District have exhibited poor water quality
20 and low rates of water production. Levels of arsenic, fluoride, nitrate, chromium or other
21 constituents in excess of Federal and State drinking water standards are common in new wells
22 constructed within the Agua Fria District south of Greenway Road over the last few years.
23 These wells will require expensive wellhead treatment systems to remove the contaminants at a
24 considerably higher total capital and operation and maintenance cost than needed for wells only a

² The City of Peoria will likely build the second regional treatment facility.

1 few years ago. To locate water, deeper drilling has been necessary, which raises capital costs
2 and increases pumping costs (electricity). In addition, yields have been lower than the Company
3 has seen for new wells north of Greenway Road. Overall, Arizona-American's recent experience
4 with new well construction—whether drilled by the Company or a developer—highlights the
5 need for surface water treatment plant capacity to minimize long-term water production facility
6 costs for ratepayers within the Agua Fria District.³

7 **B. Project Background**

8 Arizona-American holds a CAP-water subcontract for 11,093 acre-feet per year, which
9 will require treatment before it can be delivered to its Agua Fria customers. In addition,
10 Arizona-American and MWD have an agreement whereby MWD will provide Agua Fria River
11 Water it now controls to Arizona-American for treatment and delivery to its customers residing
12 within the MWD area. Arizona-American estimates that this agreement will result in up to
13 21,000 acre-feet per year of additional surface water being available for direct treatment and
14 delivery at buildout of the Agua Fria District.

15 In 2002, Arizona-American began moving forward with the regional treatment plant
16 concept by purchasing a 45-acre parcel of land at the site identified in the WESTCAPS Regional
17 Water Supply Plan. At that time, Arizona-American believed that it could obtain financing to
18 design, build, and operate a large regional facility.

19 In 2003, Arizona-American signed a contract for plant design and construction with the
20 Joint Venture of Black and Veatch (design and engineering), and Western Summit Constructors,
21 Inc. (construction). The White Tanks Plant is designed to be constructed in phases. The
22 capacity of the Phase Ia plant is 13.5 mgd and is expandable to 20 mgd (Phase Ib) with the
23 addition of one treatment unit train. Three additional phases (20 mgd each) can eventually be
24 added, depending on the rate of development in the region, for a total treatment capacity of 80

³ Mr. Jones will discuss this issue further in Section III, below.

1 mgd. As of October 2005, the design and permitting (through Maricopa County and other
2 agencies), of the Phase I plant is 95 percent complete.

3 In 2004, MWD approached Arizona-American and inquired about obtaining an
4 ownership interest in the White Tanks Plant. After MWD approached Arizona-American, the
5 Company learned that it would not be able to obtain financing to build and own the White Tanks
6 Plant as originally configured.⁴ Negotiations then shifted toward a new scenario, where MWD
7 would take responsibility for financing and building the White Tanks Plant, with Arizona-
8 American entitled to a majority of the treatment capacity. MWD's service area encompasses
9 much of Arizona-American's Agua Fria service area, and is rapidly urbanizing. MWD desires to
10 continue to provide water services and other benefits to landowners within the District
11 throughout the next century. By owning the White Tanks Plant, MWD will be able to continue
12 this mission.

13 **C. Memorandum of Understanding**

14 The negotiations between MWD and Arizona-American ultimately led to the execution
15 of a Memorandum of Understanding dated June 27, 2005 ("MOU"). A copy of the MOU is
16 Attachment A to this Report. The MOU outlines the basic framework under which MWD will
17 finance, build, and own the White Tanks Plant, Arizona-American will obtain treatment services
18 through a long-term capital lease with MWD, and an Arizona-American affiliate will operate the
19 plant through a Operation and Maintenance Agreement with MWD.

20 To mitigate the delay caused by the extended negotiations, the need for regulatory
21 approval, and MWD's public-bidding requirement—MWD will supply water from existing
22 MWD irrigation wells to Arizona-American's Agua Fria system until the plant is on-line in mid
23 2008. Arizona-American will evaluate a number of existing MWD wells to select wells that

⁴ This was because of three factors: (1) the large magnitude of the required investment at a time of multiple, competing demands for capital at the Company and its affiliates; (2) recent disappointing allowed returns on equity; and (3) the Company's eroding financial integrity from 2002-2005.

1 produce water that is acceptable, both in quantity and quality. Arizona-American will be
2 responsible for chlorinating the water and paying for the associated operating costs. This is a
3 much lower cost option than if Arizona-American had to construct additional wells during this
4 period—wells of unknown quality and yield.

5 Highlights of the MOU follow:

- 6 • Implementing the MOU requires Commission approval, which will be needed by the
7 end of the first quarter of 2006, if the mid-2008 completion date is to be met.
- 8 • MWD will purchase the plant site and plant design documents from Arizona-
9 American.
- 10 • MWD will purchase a recently constructed trunk pipeline from Arizona-American
11 that will be used to deliver treated water from the plant to the Arizona-American, City
12 of Goodyear, and Arizona Water Company water distribution systems.
- 13 • MWD will then competitively bid the construction of the plant in late 2005.
- 14 • MWD will award the construction in early 2006, contingent on Commission
15 approval.
- 16 • Financing will close early in the second quarter of 2006.
- 17 • Construction will commence shortly after the financing closes.
- 18 • Arizona-American will execute a 40-year capital lease of 7.5 mgd treatment capacity
19 with MWD.
- 20 • The City of Goodyear and Arizona Water Company are expected to contract for the
21 remaining 6 mgd of treatment capacity.
- 22 • The costs of retrofitting and connecting the interim well supplies to the Arizona-
23 American system will be included in the 40-year capital lease.

- 1 • MWD will purchase the design documents for a yet to be constructed segment of the
2 trunk pipeline. MWD will competitively bid the construction of this pipeline segment
3 in conjunction with the plant construction.
- 4 • A proportionate share of the capital cost of treated water conveyance capacity in these
5 pipelines will be part of the capital lease between Arizona-American and MWD.
- 6 • Approximately 80 percent of Arizona-American's Agua Fria customers will reside
7 within the Maricopa Water District. MWD will provide landowners within the MWD
8 District with the economic benefits of the District's ownership of the White Tanks
9 Regional Water Treatment Plant. Annual credits on Arizona-American water bills as
10 well as other mechanisms may be used to convey benefits to landowners within
11 MWD.
- 12 • The capital lease interest rate is set at 275 basis points over the long-term treasury-
13 bond rate. Assuming a 30-year treasury-bond rate of 4.25%, this would result in a
14 7% interest rate.

15 **D. Regional Plant Partners**

16 As mentioned above, Arizona-American intends to lease 7.5 mgd of the initial 13.5 mgd
17 capacity of the plant. Discussions are underway between MWD, the City of the Goodyear, and
18 the Arizona Water Company (White Tanks Division) regarding these entities contracting with
19 MWD for the other six mgd of initial plant capacity.⁵ It is expected that these and other entities
20 will contract for more capacity as MWD adds additional phases to the Plant. Multiple
21 participation allows construction of a large regional plant on one site, so that the per gallon cost
22 of treatment is less than if each entity built and owned its own treatment facility. How these
23 economies of scale benefit the Company is discussed in Section III below.

⁵ The City of Goodyear and Arizona Water Company are WESTCAPS member.

1 **E. Project Schedule**

2 Arizona-American requires additional water-production capacity by the summer of 2007
3 to meet the rapidly growing customer water demands in our Agua Fria District. As discussed
4 above, one of the significant benefits of the MOU is that, following Commission approval of the
5 transaction, MWD will connect three mgd of interim well capacity to the Arizona-American
6 system by the summer of 2007. This interim supply will bridge the gap in production capacity
7 until the plant becomes operational in 2008. The construction of the plant will require
8 approximately 24 months. Therefore, in order for the plant to be available to meet summer of
9 2008 demands, construction must begin during the second quarter of 2006. If it appears that the
10 plant will not be available by 2008, Arizona-American will need to immediately begin
11 developing additional wells to meet summer-2008 demand. An abbreviated schedule of
12 significant milestones follows:

- 13 • RFP for Construction Contract Issued (Q4 2005)
- 14 • Conditional Construction Contract Awarded (Q1 2006)
- 15 • Commission Approval (Q1 2006)
- 16 • MWD Financing Closes (Q2 2006)
- 17 • Construction Begins (Q2 2006)
- 18 • Agua Fria District Rate Filing (Q2 2007)
 - 19 ○ 2006 Test Year
- 20 • Agua Fria Rate Order (Q2 2008)
- 21 • Construction Completed (Q2 2008)
- 22 • File Final Cost Information For Verification (Q2 2008)
 - 23 ○ Plant Cost

- Lease Interest Rate⁶
- Rate Adjustments Based On AF Rate Order
- Rate Adjustments Commence (Q3 2008)
- Step 2 Filing (Q3 2009)

II. CAPITAL LEASE (James M. Kalinovich)

A. Why the MWD Agreement is a Capital Lease

1. Background

As discussed above, Arizona-American and MWD intend to enter into a contract subscribing to a major amount of capacity in the White Tanks Plant. The project will be constructed and financed by MWD and built out in Phases. Phase I should be complete by 2010, providing treatment capacity for 20 million gallons per day (mgd).⁷ The initial contract will be for 40 years, with a bargain renewal into perpetuity. An affiliate of Arizona-American will have the initial operating contract for the entire facility, which can be extended upon mutual consent of the parties.

The June 27, 2005, Memorandum of Understanding (“MOU”) outlines the basis for proceeding with the White Tanks Plant. The following relevant factors must be considered to determine the required accounting treatment for the transaction:

- Arizona-American will sell the plant design documents to MWD.
- MWD will administer the competitive bid process for the construction of the White Tanks Plant with consultation by Arizona-American.
- Under the initial agreement, Arizona-American will purchase water treatment services for 7.5 mgd of the total plant capacity of 13.5 mgd for Phase IA; however, Arizona-American can (and expects to) request a plant expansion (Phase IB) and will

⁶ The lease interest rate will not directly affect customer rates. However, as discussed in Section II, below, the lease obligation will slightly increase the Company’s overall cost of capital, which will be reflected in rates.

⁷ Phase 1A (13.5 mgd) – 2008; Phase 1B (6.5mgd) – 2010.

be responsible for the majority of economic risk associated with the Phase 1B expansion (purchase 4 mgd of 6.5 mgd additional capacity).

- MWD will sell the remaining capacity to third parties.
- The White Tanks Plant capacity can be extended to 80 mgd. Through the agreement with MWD, Arizona-American will have the right to contract for up to 50 mgd of that capacity.
- An affiliate of Arizona-American will enter into an agreement with MWD related to the Operation and Maintenance ("O&M") of the entire facility. It is anticipated that this company will be from the American Water Services Group ("AWS"). The initial contract will be for 10 years with provision for extension upon mutual consent of the parties.
- The O&M agreement will require that the plant is operated to meet all contractual and statutory obligations, and maintained so that it can operate over the lease term.
- Maintenance expenses (up to \$50,000) will be charged in the annual O&M fees, but any significant repair and replacement to the White Tanks will require that the parties either amend the existing lease or enter into a new lease for the new capital investment.
- The price paid by Arizona-American will be based upon a formula which allocates to Arizona-American a proportionate amount of capital and operation costs based upon the ratio of plant capacity to the amount purchased by Arizona-American. Variable operating costs are to be allocated in accordance with actual usage of the facility.

2. Definition of a Lease

FAS 13, "Accounting for Leases," defines a lease as an agreement conveying the right to use plant, property or equipment usually for a stated period of time. The definition includes agreements that, although not nominally identified as a lease, convey the right to use the

property, plant, or equipment. FASB Emerging Issues Task force (EITF) Issue 01-08, “Determining Whether an Arrangement Contains a Lease,” explains that the evaluation of whether an arrangement contains a lease should be based on the substance of the arrangement.

Paragraph 12 of EITF 01-08 states that an arrangement conveys the right to use property, plant or equipment if any one of the following is met:

a. The purchaser has the ability or right to operate the property or direct others to operate the property while obtaining more than a minor amount of output.

b. The purchaser has the ability or right to control physical access to the property while obtaining more than a minor amount of output.

c. It is remote that one or more parties other than the purchaser will take more than a minor amount of the output during the term of the arrangement, and the price paid is neither contractually fixed per unit of output or equal to the current market price per unit of output at the time of delivery.

3. Application to Arizona-American and MWD agreement

The arrangement between Arizona-American and MWD contains a lease due to the substance of the agreement meeting the requirements of both a) and b) in paragraph 12 of EITF 01-08.

Subparagraph 12(a) is satisfied because an affiliate of Arizona-American will operate the plant and Arizona-American will direct how much of its contractual capacity will be used at any one time. Therefore, Arizona-American in effect has the ability to direct the proper operation of a majority of the plant and to control its property. Arizona-American will approve the significant and necessary operating policies in the O&M agreement to be signed with MWD. Separately, and by agreement, Arizona-American will guarantee to purchase 57.5% of the treatment plant’s output upon completion; thus, it will be obtaining more than a minor amount of the plant’s output.

1 Arizona-American have exclusive rights to 57.5% of plant capacity – no one else can use
2 this capacity (MWD cannot use Arizona-American capacity to supply any other customer
3 without the consent of Arizona-American). The pricing formula includes a fixed charge for a
4 minimum amount of the plant's capacity, and a charge for the operating costs related to the
5 plant's capacity allocated to Arizona-American. Finally, MWD will build the plant to
6 specifically meet the needs of Arizona-American and does not have the ability to use other
7 treatment plants to service the agreement.

8 **B. Capital versus Operating Lease**

9 Once a lease is established, it is classified from the standpoint of the lessee as either a
10 capital lease or an operating lease. An operating lease is any lease that does not meet the criteria
11 of a capital lease. Under paragraph 7 of FAS 13, a lease is classified as a capital lease if it meets
12 one or more of the following criteria:

- 13 a) The lease transfers ownership at the end of the lease term.
14 b) The lease contains a bargain-purchase option.
15 c) The lease term is equal to 75% or more of the estimated useful life of the leased
16 property.
17 d) The present value of the minimum lease payments (excluding executory costs
18 such as taxes, maintenance, insurance, etc.) is equal to or greater than 90% of the fair value of
19 the leased property.

20 Because the transaction between Arizona-American and MWD will meet criterion c) and
21 d) above, the lease will be classified as a capital lease.

22 **C. Accounting for Capital Leases**

23 **1. Financial Accounting**

24 Capital leases are recorded as an obligation and an asset equal to the present value of
25 minimum lease payments during the term of the lease (excluding executory costs), not to exceed

the fair value of the leased property. If the lease meets criterion a) or b) of FAS 13 above, the asset is depreciated according to the normal depreciation policy for owned assets. If the lease does not meet either a) or b) above, the asset is depreciated according to the lessee's normal depreciation policy, except the period of depreciation is the lessor of the lease term (lease term shall include the period covered by a bargain renewal option) or the asset's useful life.

2. Regulatory Accounting

NARUC Accounting Instruction 22 governs regulatory accounting for capital leases.

22. Utility Plant - Accounting for Capital and Operating Leases

A. For each lease entered into, the utility shall maintain sufficient documents and other background information as necessary to determine whether the lease is a capital or operating lease.

This information includes but is not limited to:

- (1) Evidence or documents of ownership;
- (2) Signed copies of the lease agreement;
- (3) Estimated life of the leased property;
- (4) Evidence as to the value of the leased property;
- (5) Evidence as to the lessor's implicit interest rate (if available);
- (6) Evidence as to the lessee's borrowing rate; and
- (7) The amount and disposition of executory costs (taxes, maintenance and insurance).

B. Leases shall be accounted for by the utility as described in Statement of Financial Accounting Standards Nos. 13 (as amended) and 71 published by the Financial Accounting Standards Board; however, the Commission may elect to approve the entries made to the utility's accounts in recording the effect of utility leases.

C. Capitalized leases shall be recorded in the appropriate plant in service account(s) which describe the type of asset leased. These records shall be maintained in sufficient detail such that the utility will be able to report the number, general nature, and residual balances of all capitalized leased assets as well as any related leasehold amortization balances and the balance of any leasehold obligations.

1 Instruction 22 is clear that the MWD transaction should be accounted as a capital lease
2 for regulatory purposes since it qualifies as a capital lease under FAS 13. The intent of this
3 Report is to provide the information required by Instruction 22.

4 **D. Rate Base and Depreciation**

5 Attached as Attachment B is a pro forma schedule that derives the rate base additions for
6 Phase 1A and 1B of the MWD Capital Lease. Based on Attachment B, the estimated gross rate
7 base addition in 2008 for Phase 1A is \$37,413,874,⁸ and the addition for Phase 1B is
8 \$4,615,384.⁹

9 For a capital lease asset with a bargain renewal, it is appropriate to depreciate the asset
10 over its useful life. In Schedule B-3 of Attachment C, Mr. Jones derives a 2.63% depreciation
11 rate based on the expected lives of the various assets that make up the lease asset. This amounts
12 to a 38.0 year useful life.

13 **E. Financing and Capital Structure**

14 Arizona-American will finance the leased asset with a combination of 40% equity and
15 60% debt. American Water Works will contribute the required equity and the capital lease debt
16 rate will be set at 275 basis points over the 30-year Treasury bond rate (according to terms of
17 lease). At present rates this is approximately 7.0%. The actual rate will be set when MWD's
18 financing closes, which will be shortly after the Commission's approval of this application.
19 Because this debt will refinance a certain amount of short-term borrowings from American
20 Water Capital Corp, we anticipate a slight increase in Arizona-American's overall cost of capital,
21 which will be addressed in the Company's 2007 Agua Fria rate case. This slight increase in debt
22 costs reflects higher interest rates on long-term fixed rate third party debt versus short-term,
23 variable-rate American Water Capital Corp debt.

⁸ $\$67,344,973 \times (7.5/13.5) = \$37,413,874.$

⁹ $\$7,500,000 \times (4.0/6.5) = \$4,615,384.$

III. **COMPARISON TO OTHER OPTIONS (Ray L. Jones)**

A. **Description of Options**

The three options reviewed are summarized as follows:

- **White Tanks Plant/MWD Lease** – This option is the one outlined in the MOU and discussed by Mr. Larson and Mr. Kalinovich. Under this option Arizona-American will lease 11.5 mgd of capacity in the first phase (7.5 mgd in Phase 1A and 4 mgd in Phase 1B) of a regional water treatment facility to be constructed by MWD. Phase I of the White Tanks Plant has a capacity of 20 mgd and will be constructed in two sub-phases of 13.5 mgd and 6.5 mgd. The White Tanks Plant will treat Arizona-American CAP water directly delivered to the plant through MWD's Beardsley Canal. Treated water will be transported to storage facilities located south of Greenway Road in the Agua Fria District through a large-diameter regional transmission pipeline.
- **Additional Wells** - Drill wells within the Agua Fria District to obtain 11.5 mgd capacity. Due to poor water quality and diminished well production, particularly in the portion of the Agua Fria District south of Greenway Road, this option assumes the following:
 - Given recent results, some type of treatment will be required;
 - Wells will produce an average of 600 gallons per minute, or 0.864 mgd;
 - In determining the firm capacity of the wells, one in five wells will be considered unusable either long term or at any particular time. Put another way; a 20% reserve margin is needed to provide adequate firm capacity.
 - Wells will need to be concentrated in the northern and central portions of the Agua Fria District, requiring the construction of a large-diameter

transmission pipeline to storage facilities in the southern Agua Fria District.¹⁰

- Arizona-American will recharge its CAP water at a regional recharge facility in the West Valley for annual recovery from the wells.

- Construct Standalone Water Treatment Plant (“White Tanks Plant”) - Construct a surface water treatment plant exclusively for Agua Fria District demands. Phase I of the Standalone White Tanks Plant has a capacity of 12.5 mgd and will be constructed in two sub-phases of 6.25 mgd each. The Standalone White Tanks Plant will treat Arizona-American CAP water directly delivered to the plant through MWD’s Beardsley Canal. Treated water will be transported to storage facilities in the southern Agua Fria District through a large-diameter regional transmission pipeline.

B. Analysis

For each alternative a capital cost estimate and operating cost estimate were developed. For each capital cost estimate an estimate of annual depreciation was developed and the annual cost of capital was calculated using Arizona-American’s proposed debt ratio and debt and equity costs.

The cost of the White Tanks Plant and the depreciation rates are the figures provided by Mr. Kalinovich in Section II, above. The Well System cost estimates are based on Arizona-American’s current cost to drill and equip wells in the Agua Fria District and upon arsenic treatment cost information provided in Arizona-American’s pending arsenic surcharge filing. Cost estimates for the Standalone White Tanks Plant were derived from the cost data developed for the White Tanks Plant and estimates developed by Arizona-American, and adjusted to reflect the reduced economy of scale.

¹⁰ This is the same pipeline required to deliver treated water from a treatment facility to the southern Agua Fria District.

The following table summarizes the results of the study:¹¹

Estimated Annual Costs			
	White Tanks Regional Water Treatment Plant	Well Supply System with Arsenic Treatment	Standalone Water Treatment Plant
Annual Cost of Capital			
Annual Operating Costs	\$5,885,559	\$5,014,094	\$7,813,492
Water Resource Annual Costs	1,319,698	3,013,404	1,524,252
	1,349,997	1,174,807	1,349,997
Total Annual Costs	\$8,555,254	\$9,202,305	\$10,687,741
Difference from Low-cost Option	+0.0%	+7.6%	+24.9%
Annual Cost Per 1,000 gallons produced	\$ 2.55	\$ 2.74	\$ 3.18

My complete analysis is shown in Attachment C.

The analysis indicates that the White Tanks Plant and the Well Drilling options have similar annual costs, while the Standalone White Tanks Plant is significantly higher. The analysis indicates that the Standalone White Tanks Plant should not be pursued.¹²

The annual cost of the White Tanks Plant and the Well System are within 6% of each other, with the White Tanks Plant having a higher cost of capital than the Well System and the Well System having a higher annual operating cost. Given the closeness in annual cost, both options appear viable. However, upon examination of the assumptions underlying the options, the White Tanks Plant emerges as the superior option.

There are fewer uncertainties associated with the White Tanks Plant option. Land has been purchased on the Beardsley Canal. Arizona-American has a contract for CAP Water and has an MOU with MWD. A CAP-water wheeling agreement is already in place with MWD.

¹¹ For simplicity's sake, we have assumed that all facilities are completed at the same time.

¹² No MWD credits would be available in the Standalone option.

1 Construction documents are nearly complete and construction costs have been estimated by the
2 design-build joint venture based on the actual construction documents. The needed large-
3 diameter transmission main is currently under construction. The White Tanks Plant option is
4 also consistent with the WESTCAPS regional water supply plan and with the requirements of the
5 Arizona Groundwater Management Act that new development be served with renewable water
6 supplies. Finally, water providers throughout the Phoenix metropolitan area, including Arizona-
7 American, already successfully treat and deliver CAP water to their customers.

8 In contrast, the cost of the well-construction option is based on many uncertainties. It
9 assumes that the well sites can be successfully acquired. It assumes that each well can be
10 permitted and will actually produce an average of 0.864 mgd. It assumes that treatment will only
11 be required for arsenic contamination. Each of these assumptions has a relatively high risk of
12 being wrong. In the Agua Fria District Arizona-American and developers have sometimes found
13 it difficult to locate and obtain suitable well sites. ADWR well spacing regulations have made
14 permitting of high capacity wells extremely difficult. Several wells developed by Arizona-
15 American cannot produce 0.864 mgd flow rates with affected wells located primarily in the
16 southerly areas of the Agua Fria District. Several wells drilled or tested for potable water supply
17 in the Agua Fria District have proven completely unusable.

18 Even if our well assumptions were to prove accurate, continuing to drill wells is contrary
19 to public policy. As discussed in Section I, above, groundwater modeling studies conducted by
20 ADWR and by the Bureau of Reclamation warn that continued reliance on groundwater to
21 support new development would cause unacceptable groundwater level declines and accelerate
22 land-subsidence problems. Also, the WESTCAPS study concluded that the area's water
23 suppliers should maximize their use of CAP and other surface water resources and recommended
24 the construction of two regional treatment facilities, one of which is the White Tanks Plant.

1 Finally, the Commission has strongly encouraged utilities under its jurisdiction to make full use
2 of their CAP allocations, which cannot be delivered to customers without treatment.

3 **C. Conclusion**

4 The Standalone Water Treatment Plant option is significantly more expensive than
5 leasing treatment capacity in MWD's White Tanks Plant. The dollar cost of continuing to rely
6 on new wells is slightly higher than leasing treatment capacity, is based on relatively optimistic
7 assumptions, and would be contrary to public policy. For these reasons, leasing treatment
8 capacity in MWD's White Tanks Plant is the favored option.

9 **IV. RATE MATTERS (Thomas M. Broderick)**

10 **A. Proposed Procedure**

11 Arizona-American requests that the Commission approve the following rate-making
12 procedure for the Company to recover the costs associated with entering into the MWD capital
13 lease. This procedure is similar to the Commission's ACRM process to recover the
14 extraordinary costs associated with arsenic remediation.

15 **1. Initial Approvals**

16 **a. Transaction Approval**

17 MWD's construction of the White Tanks Plant and its provision of interim water supplies
18 to Arizona-American are both contingent upon Arizona-American's receipt of the requested
19 approvals from the Commission. MWD is striving to put the White Tanks Plant in service by
20 summer 2008 in order to satisfy demands in the Agua Fria District, the Town of Goodyear, and
21 Arizona Water's White Tanks service territory. Construction of the White Tanks Plant will take
22 approximately two years. To meet this goal, a construction contract must be awarded (through
23 competitive bidding) by the second quarter of 2006. This will require Commission approval of
24 the transaction by the end of the March 2006.

1 The Company proposes, in lieu of direct testimony, to make the authors of the White
2 Tanks Report available as a witness panel in the hearing on this application to sponsor the White
3 Tanks Report and answer any questions about it. The Company also expects to call one or more
4 witnesses on behalf of MWD.

5 **b. Revised Hook-up Fees Set**

6 As discussed below, Arizona-American is asking to revise its existing water hook-up fees
7 for the Agua Fria Water District so that growth can help raise additional funds to reduce the rate
8 impact of the White Tanks Capital Lease. Having developers fund the cost of water treatment
9 needed to serve future development is consistent with cost-causation principles, with
10 Commission precedent, and with the fees charged by municipal water providers to fund new
11 infrastructure. Arizona-American is asking that the revised hook-up fees be approved as soon as
12 possible in this case, and no later than the second quarter of 2006.

13 Arizona-American's analysis of the required amount of the revised hook-up fee is
14 provided in Section IV(C), below.

15 **2. 2007 Agua Fria Rate Case**

16 Early in the second quarter of 2007, Arizona-American will file a rate case using a 2006
17 test year for its Agua Fria Water District. Based on this filing, the Commission will determine
18 the cost of service for the Agua Fria District, including rate base and authorized return on equity.
19 The Company projects the Order will be issued sometime in the second quarter of 2008.

20 **3. 2008 White Tanks Filing (Step 1 Filing)**

21 To recover its extraordinary costs associated with the White Tanks Plant, Arizona-
22 American proposes a procedure similar to that approved by the Commission to deal with the
23 extraordinary capital expenditures required to comply with the revised federal arsenic standards
24 for drinking water. Like the an ACRM Step 1 filing, once the White Tanks Plant is complete and
25 providing service, the Company will make a filing to determine the monthly rates necessary to

1 recover the revenue requirement associated with the MWD Capital Lease, including return on
2 rate base, depreciation, and fixed O&M. This revenue requirement will be based on the revenue
3 requirement components that were determined, roughly contemporaneously, in the 2007 general
4 rate filing for the Agua Fria District. An adjustment would need to be made for the slightly
5 increased cost of capital associated with carrying the debt cost associated with the White Tanks
6 Plant lease.

7 The White Tanks Plant rate base will be offset by the cumulative contributions received
8 from the revised hook-up fees, discussed below. As discussed below, because of the funds
9 generated by the hook-up fees, Arizona-American expects that the amount of the surcharge will
10 be relatively small.¹³

11 The final component of this filing will be to reset the hook-up fee. In support of this
12 component, Arizona-American will file schedules of projected customer additions by meter size
13 along with the associated water facilities needed to satisfy this new demand. These projects will
14 include Arizona-American's share of Phase 1B of the White Tanks Plant and will likely also
15 include future phases of the White Tanks Plant.

16 4. Step 2 Filing

17 Like an ACRM Step 2 filing, approximately one year after the White Tanks Plant begins
18 operation, Arizona-American will make a filing to begin recovery through a surcharge of the
19 variable O&M costs associated with its share of the White Tanks Plant capacity. Examples of
20 these type of costs are chemicals, electric power, residuals, and maintenance. These costs are
21 projected to be approximately \$70,000 per mgd/year. First-year variable costs would be deferred
22 and recovered along with second-year variable costs.

¹³ See Attachment E.

1 **5. Additional Future Filings**

2 Arizona-American plans to lease capacity in additional phases of the White Tanks Plant.
3 The Company would make additional filings associated with a general rate case to adjust for the
4 rate impacts of these capacity additions.

5 **B. Projected Rate Impact Without Changes to Hook-up Fees**

6 Attachment D is a schedule showing the projected rate impact of the MWD capital lease
7 when the White Tanks plant becomes operational (assumes July 2008). Attachment D begins
8 with a one-page sheet detailing the Company's eligible capital expenditures to date and
9 forecasting additional capital expenditures. Next is an analysis of hook-up fee revenue to date
10 and forecasted hook-up fee revenues through June 2008. This assumes that the Company's two
11 existing water hook-up fees were unchanged.¹⁴ Finally, based on no hook-up fee changes,
12 Attachment D shows that the full-year revenue requirement associated with Phase 1A of the
13 MWD capital lease would be approximately \$5 million. For an average customer, this revenue
14 requirement would need a rate increase of approximately \$10.00/customer/month.

15 **C. Proposed Hook-up Fee**

16 Arizona-American currently collects two water-related hook-up fees in the Agua Fria
17 District. The first is the Central Arizona Project Hook-up Fee ("CAP Hook-up Fee"), which was
18 intended to recover the cost of acquiring and holding CAP water for the Company's Agua Fria
19 customers.¹⁵ Developers pay a one-time charge of \$ 257.00 per residential building, and \$150
20 per equivalent residential unit ("ERU"), based on meter size, for commercial buildings. Funds
21 generated by this fee are treated as revenue and reduce the company's unrecovered costs of
22 acquiring CAP water to serve the Agua Fria District. The Company estimates that CAP Hook-up

¹⁴ Arizona-American's CAP fee is due to expire sometime in the second quarter of 2006. As discussed below, the Company proposes to combine the CAP and Water Facility Hook-up Fees into one hook-up fee.

¹⁵ Docket No. E-01032B-00-0205, Decision No. 63334, February 2, 2001.

Fee will have fully funded its intended purpose by the end of the second quarter, 2006, when, as required by the Order, it would end.

Arizona-American also charges a Water Facilities Hook-up Fee in its Agua Fria District.¹⁶ This fee is intended to offset the costs of new water facilities needed to serve new customers, including new treatment facilities. The fee is based on based on meter size and starts at \$1,150 for a 5/8 x 3/4-inch meter. This is a one-time fee per service connection or residential lot within a platted subdivision. Funds generated by this fee are treated as contributions in aid of construction ("CIAC"). CIAC funds are revenue neutral and directly offset rate base. To date the funds raised by this hook-up fee have funded construction of a number of water infrastructure projects.¹⁷

To reduce the rate impact of the MWD Capital Lease, Arizona-American proposes to discontinue the Water Facilities Hook-up Fee, and extend the CAP Hook-up Fee, with modifications. This proposal would largely offset the rate increase needed to recover the revenue requirement and other costs associated with the MWD Capital Lease.

The CAP Hook-up Fee would continue in its present form until the Commission issues an order revising its terms and discontinuing the Water Facilities Hook-up Fee.

Effective after a Commission order approving the revisions, the revised CAP Hook-up Fee would increase as follows:

Meter Size	Factor	Water Facilities Hook-up Fee	CAP Hook- up Fee	WF + CAP Hook-Up Fees	Revised CAP Hook- up Fee	Increase
5/8 x 3/4"	1.00	\$1,150.00	\$150.00	\$1,300.00	\$1,800.00	\$500.00
3/4"	1.50	\$1,725.00	\$225.00	\$1,950.00	\$2,700.00	\$750.00
1"	2.50	\$2,875.00	\$375.00	\$3,250.00	\$4,500.00	\$1,250.00
1 1/2"	5.00	\$5,750.00	\$750.00	\$6,500.00	\$9,000.00	\$2,500.00
2"	8.00	\$9,200.00	\$1,200.00	\$10,400.00	\$14,400.00	\$4,000.00

¹⁶ Docket Nos. SW-01303A-02-0628 & W-01303A-02-0629, Decision No. 66512, November 10, 2003.

¹⁷ See Attachment D, p. 3.

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3"	16.00	\$18,400.00	\$2,400.00	\$20,800.00	\$28,800.00	\$8,000.00
4"	25.00	\$28,750.00	\$3,750.00	\$32,500.00	\$45,000.00	\$12,500.00
6"	50.00	\$57,500.00	\$7,500.00	\$65,000.00	\$90,000.00	\$25,000.00
8"	100.00	\$115,000.00	\$15,000.00	\$130,000.00	\$180,000.00	\$50,000.00

1 The existing CAP Hook-up fee has a separate residential fee of \$257 per household.¹⁸ By
2 contrast, the Water Facilities Hook-up Fee is based solely on meter size. To make the above
3 chart simple, the present different treatments for residential connections has been ignored. The
4 Company recommends that the revised CAP Hook-up Fee be based solely on the size of the
5 customer's meter. Attachment E details the additional funds that would be collected from a
6 revised CAP Hook-up fee.

7 Arizona-American proposes that funds from the revised CAP Hook-up Fee be treated as
8 CIAC, but booked separately to be accumulated and used to offset the ratebase increase
9 attributable to the MWD Capital Lease. As shown of Attachment E, this would decrease the
10 annual revenue requirement associated with the MWD capital lease to approximately \$3 million,
11 and the associated rate increase would be reduced to approximately \$6.00/per customer/month.

12 The proposed adjusted CAP hook-up fees are reasonable. Existing customers will benefit
13 from receiving treated CAP water and reduced groundwater usage, so they should bear a portion
14 of the White Tanks Plant's cost. However, because much of the capacity will be used to satisfy
15 future growth, using hook-up fees to pay for a large part of the White Tanks Plant is also
16 appropriate. Finally, the Company's hook-up fees have long lagged those charged by many
17 municipal water suppliers. For example, in the City of Peoria, the water hook-up fee for ¾ and
18 one-inch meters is \$3,497.

19 As discussed above, Arizona-American proposes to include the necessary data to revise
20 the hook-up fees as part of its 2008 Step Two Filing.

¹⁸ Except for age-restricted dwellings, where the charge is reduced to \$150.

1 **D. Regulatory Requests**

2 As discussed above, Arizona-American is asking for the following specific regulatory
3 approvals from the Commission as part of its order in this proceeding:

- 4 • Authorize Arizona-American Water Company under A.R.S. § 40-301 *et. seq* to issue
5 an evidence of indebtedness in an amount equal to the capital lease asset and
6 determined consistent with the methodology set forth in Attachment B;
- 7 • Authorize Arizona-American Water Company under A.R.S. § 40-285 to transfer the
8 Pipeline Main and other assets to Maricopa County Municipal Water Conservation
9 District Number One;
- 10 • Find that it is prudent for Arizona-American Water Company to enter into the
11 agreements contemplated in the MOU, including the proposed capital lease with
12 Maricopa County Municipal Water Conservation District Number One;
- 13 • Approve the regulatory process set forth above;
- 14 • Authorize the ratemaking treatment set forth above for the proposed capital lease and
15 associated documents between Arizona-American Water Company and The Maricopa
16 County Municipal Water Conservation District Number One; and
- 17 • Authorize, as set forth above, Arizona-American Water Company to implement
18 revised CAP hook-up fees to reduce the rate impact of the proposed capital lease.
19

Appendix (Author CVS)

Keith R. Larson
Water Resources Director, Western Region
American Water
19820 N. 7th Street, Suite 201
Phoenix, AZ 85024

Job Responsibilities:

American Water Western Region - Manage water rights, short and long-range water supply planning programs, manage the company's water conservation programs, and regulatory issues related to water resources.

Previous Relevant Work Experience:

Citizens Water Resources – Phoenix, Arizona, 4/2001 to 1/2002

- Manage water rights
- Short and long-range water supply planning programs
- Manage Water Conservation Program

City of Phoenix Water Department – Phoenix, Arizona, 8/1988 to 4/2001

- Principal Water Resources Planner
- Manage water rights
- Direct short and long-range water supply planning program
- Develop reclaimed water implementation strategies
- Well system development planning

Arizona Department of Water Resources – Phoenix, Arizona, 1986 to 1988

- Planning Coordinator and primary Editor for Second Management Plans for Arizona's Active Management Areas

Education:

M.S., Hydrology, Oregon State University – Corvallis, Oregon, 1981
B.S., Watershed Science, Utah State University, Logan, Utah, 1978

Previous Experience Testifying in Arizona:

Citizens Water Resources/Arizona American Water - Sun Cities Groundwater Savings Project filing

James M. Kalinovich

1025 Laurel Oak Drive
Voorhees, NJ 08043
(856) 309 4572

Work Experience

American Water, Voorhees NJ – Division of RWE, Germany 12/04 - Current
Vice President & Treasurer – Leading the US Treasury activities for American Water and all US subsidiaries of RWE. Responsible for all financing (over \$2 Billion in outstanding tax-exempt bonds), Risk Management and investment activities. In addition, leading the new business financial analysis team for all business development activities within North America.

Amkor Technologies, West Chester PA 9/00 – 12/04
Vice President & Treasurer –Working for CFO leading Amkor's Treasury, Tax, Risk Management, Financial Planning and Accounting Support organizations (global billing & collection and US invoice processing).

Successfully transitioned company's capital structure to meet the needs of an unprecedented industry slowdown. Worked closely with the company's CEO/Chairman and Board (meet quarterly with audit committee) to maintain liquidity and stabilize the company's long-term capitalization. Accessed public market through six public offerings during past 3 years including high yield /convertible bond offerings and a follow-on equity offering (road show experience). Negotiated and promoted several major revision to syndicated secured loan agreement (originally 80 financial institutions participate) with a final pre-payment in 2004.

Provided finance support for various business development initiatives including tax, financing and integration into the global risk management structure.

Reorganizing our legal entity structure to establish a more tax efficient entity structure to finance foreign operations and new acquisitions.

Expanded various finance policies and procedures to further advance corporate processes to be Sarbanes-Oxley compliant.

Implemented an Oracle suite of financial applications including Treasury, Cash management, Payables and Receivables.

Merck & Co., Inc., London Treasury Office
Director – European Treasury Centre 11/97 – 9/00

Manage all aspects of Merck's European Treasury Center and directly supervise a staff of three professionals and indirectly manage over ten local European Treasurers. Supervise local company's controller and the related financial reporting, tax and hedging activities. Responsible for European cash concentration activities, investment of USD350 million short-term portfolio (average balance), and management of in excess of 10 Billion FX hedge transactions annually.

Developed and implemented various repatriation strategies to minimize global taxes while maximizing U.S. cash flow. Financed all new and existing European operations.

Delivered an Internet based European cash management and global netting system (package from Alterna Technologies integrated with Sunguard Treasury system). Last

assignment was to lead the global implementation of Alterna's worldwide internet based treasury system. System to be fully integrated with JDE accounting package and accessed both locally and centrally.

Manager- International Treasury Services 7/95 - 10/97

Responsible for all corporate treasury support for Merck's Asian affiliates. Financed local operations and evaluated all tax driven financing and repatriation strategies. Implemented the legal entity structure of major joint venture.

Senior Internal Auditor 7/94 - 6/95

Prepared two non-core divisions for divestiture. Performed pre-sale due diligence work on divisions sold for in excess of 1 Billion.

Heller Financial 8/91 - 8/92

Evaluated the asset base of numerous high risk lending clients primarily in the textile industry. Reviewed financial projections and performed due diligence review of ongoing activities.

Deloitte and Touche 8/89 - 7/91

Member of audit team serving broad group of clients in retail, manufacturing and financial services industry.

Education

New York University

MBA Finance/Information Systems, May 1994

Penn State

BS with honors in Accounting, May 1989

Ray L. Jones P.E.
Principal
ARICOR Water Solutions
25213 N. 49th Drive
Glendale, Arizona 85310

EMPLOYMENT HISTORY

2004 – Present **ARICOR Water Solutions**
Principal

ARICOR Water Solutions offers a wide range of services to the private and public sectors, including: water resources strategy development; water rights evaluation; water, wastewater and water resource master planning; value engineering; development of regulatory strategies. ARICOR Water Solutions supports water solutions with expert witness testimony and litigation support.

2002 to 2004 **Arizona-American Water Company**
President

Responsible for leadership of the Arizona business activities of Arizona-American Water Company. Key responsibilities include developing and evaluation new business opportunities, developing strategic plans, establishing effective government and community relations, insuring compliance with all regulatory requirements, and providing management and guidance to key operations and support personnel.

1998 to 2002 **Citizens Water Resources, Arizona Operations**
Vice President and General Manager

Responsible for leadership of the Arizona regulated and unregulated business activities of Citizens Water Resources. Key responsibilities included developing and evaluation new business opportunities, developing strategic plans, establishing effective government and community relations, insuring compliance with all regulatory requirements, and providing management and guidance to key operations and support personnel.

1990 to 1998 **Citizens Water Resources, Arizona Operations**
Engineering and Development Services Manager

Responsible for management of a diverse group of business growth related activities. Responsibilities include: marketing of operation and maintenance services (unregulated business growth), management of new development activity (regulated business growth), management of engineering functions (infrastructure planning and construction), management of water resources planning and compliance, management of growth-related regulatory functions (CC&N's and Franchises), and management of capital budgeting functions and capital accounting functions.

1985 to 1990 **Citizens Water Resources, Arizona Operations**
Civil Engineer

Responsible for the planning, coordination and supervision of capital expansion and major maintenance and rehabilitation projects as assigned. Responsible for development of capital program for Maricopa County Operations.

EDUCATION

Arizona State University – Master of Business Administration (1991)
University of Kansas – Bachelor of Science in Civil Engineering (1985)

PROFESSIONAL CERTIFICATION

Registered Professional Engineer – Civil Engineering – Arizona
Professional Engineer – Civil Engineering – California
Certified Operator – Wastewater Treatment, Wastewater Collection, Water Treatment,
Water Distribution – Arizona

TESTIFYING EXPERIENCE

Testimony has been provided before the Arizona Corporation Commission in the dockets listed below. Unless otherwise indicated testimony was provided on behalf of the utility.

Filing Year	Utility(ies)	Filing Type(s)	Docket(s)
1992	Sun City West Utilities Company	CC&N Extension (Expansion of Sun City West)	U-2334-92-244
1993	Sun City Water Company Sun City Sewer Company	CC&N Extension (Addition of Coyote Lakes)	U-1656-93-060 U-2276-93-060
1993	Tubac Valley Water Co., Inc.	CC&N Extension (Various Subdivisions on western border)	U-1595-93-241
1993	Sun City West Utilities Company	CC&N Extension (Expansion of Sun City West)	U-2334-93-293
1995	Citizens Utilities Company Sun City Water Company Sun City Sewer Company Sun City West Utilities Company Tubac Valley Water Company	Ratemaking	E-1032-95-417 U-1656-95-417 U-2276-95-417 U-2334-95-417 U-1595-95-417
1996	City Water Company Sun City Sewer Company	CC&N Extension (Acquisition of Youngtown)	U-1656-96-282 U-2276-96-282
1996	Citizens Utilities Company	CC&N Extension and Deletion (Realignment of Surprise Bdry.)	E-1032-96-518
1998	Sun City Water Company Sun City West Utilities Company	CAP Water Plan and Accounting Order (Sun Cities CAP plan)	W-01656A-98-0577 SW-02334A-98-0577
2000	Citizens Water Resources Company of Arizona Citizens Water Services Company of Arizona	CC&N Extension and Accounting Order (Anthen Jacka Property and Phoenix Treatment Agreement)	SW-3455-00-1022 SW-3454-00-1022
2000	Citizens Communications Company Citizens Water Services Company of Arizona	CC&N Extension and Approval of Hook-Up Fee (Verrado)	W-0132B-00-1043 SW-0354A-00-1043
2002	Arizona-American Water Company	Ratemaking	WS-01303A-02-0867 WS-01303A-02-0868 WS-01303A-02-0869 WS-01303A-02-0870 WS-01303A-02-0908
2004	Arizona-American Water Company Rancho Cabrillo Water Company Rancho Cabrillo Sewer Company	CC&N Transfer	WS-01303A-04-0089 W-01303A-04-0089 SW-03898A-04-0089

2004	Johnson Utilities Company, LLC (Representing Pulte Home Corporation)	CC&N Extension	WS-02987A-04-0288
2005	Perkins Mountain Utility Company Perkins Mountain Water Company	New CC&N & Initial Rates	WS-20379A-05-0489 W-20380A-05-0490

Thomas M. Broderick
Manager, Rates & Regulatory Affairs, Western Region
Arizona-American Water Company
19820 N. 7th Street, Suite 201
Phoenix, AZ 85024

Job Responsibilities:

Manage regulatory affairs and rate case and other state regulatory proceedings, primarily in Arizona and Texas.

Previous Relevant Work Experience:

Arizona Public Service Company, an electric utility, 1984 – 1996

- Supervisor Regulatory Affairs
- Manager, Planning

PG&E Corporation

- Director, External Relations, Western Region

Education:

M.S., Economics, University of Wisconsin – Madison, 1981
B.S., Economics, Arizona State University, Tempe, 1979

Previous Experience Testifying in Arizona:

- Arizona American Water “ACRM” case
- ACC “Track B” competitive procurement rules
- PG&E Energy Services’ statewide competitive CC&N application
- Arizona School Board Association application for exemption from electric stranded costs
- APS Integrated Resource Planning, various proceedings

ATTACHMENT A

Memorandum of Understanding dated June 27, 2005

MEMORANDUM OF UNDERSTANDING

MEMORANDUM OF UNDERSTANDING ("MOU") dated as of June 27, 2005, between MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE, a political subdivision of the State of Arizona ("MWD"), and ARIZONA-AMERICAN WATER COMPANY, an Arizona corporation ("AAW") (collectively, the "Parties").

RECITALS:

A. AAW is the owner of all right, title and interest in and to certain real property more particularly described on Exhibit B (the "Site").

B. AAW and White Tanks WTP Joint Venture (the "Design/Build Joint Venture") have entered into the "White Tanks Regional Water Treatment Plant Agreement for Target Cost Design-and-Construct Two-Phase Contracts," dated as of October 29, 2003 (the "Design/Build Agreement"), for the design and construction on the Site of a water treatment plant and related facilities (collectively, the "Plant").

C. AAW has planned, designed and commenced construction of a pipeline that can be used for transportation of water from the Plant and from other sources ("Pipeline"). (The Site, the Plant and the Pipeline are, collectively, the "Facility".)

D. MWD desires to complete the acquisition and construction of the Facility and to own the Facility.

E. The Parties desire that (1) AAW transfer the Site to MWD, (2) AAW and MWD arrange for completing the design of the Plant and, in lieu of the Design/Build Agreement, awarding a contract for construction of the Plant by means of a competitive-bidding process, (3) MWD and AAW jointly coordinate the construction of the Plant by the contractor, (4) AAW transfer the Pipeline to MWD, (5) MWD and an affiliate of AAW enter into an agreement for operation and maintenance of the Facility, (6) AAW and others agree to purchase both water treatment and delivery services from MWD, (7) MWD agree to expand the capacity of the Facility at AAW's request under certain circumstances, (8) AAW have a right to repurchase the Facility under certain circumstances, and (9) the benefits of MWD's ownership of the Facility pass through in some manner to AAW's customers who are MWD landowners.

F. This MOU outlines those objectives and the Parties' intentions as to realizing those objectives and constitutes the First Milestone in the Parties' efforts to realize those objectives.

AGREEMENT:

NOW, THEREFORE, the Parties agree as follows:

1. Definitions. Capitalized terms and other terms used in this MOU have the meanings set forth in Exhibit A, unless the term is defined elsewhere in this MOU and unless the

context otherwise requires. Those terms include the singular and the plural forms of defined terms.

2. Site.

a. Site Purchase Agreement. On or before the Second Milestone, MWD and AAW will enter into an agreement pertaining to the purchase of the Site by MWD from AAW (the "Site Purchase Agreement"). The Site Purchase Agreement will provide for, among other things, the matters described in the following paragraphs (b) through (e).

b. Site Purchase Price.

i. Fair Value. The purchase price for the Site (the "Site Purchase Price") will be the lesser of appraised value or \$30,000 per acre.

ii. Cash Consideration. The Site Purchase Price will be payable in cash in full at the closing of the purchase of the Site.

c. Closing of Site Purchase. To facilitate the timely implementation of the competitive-bidding process described in Section 3(c)(i), the closing of the purchase of the Site will occur (i) concurrently with the closing of the purchase of the Design Documents as described in Section 3(b)(iii), and (ii) on or before the Third Milestone.

d. Repurchase of Site. The Site Purchase Agreement (or an ancillary agreement) will provide that AAW will repurchase the Site for the Site Purchase Price if the Third Milestone or the Fourth Milestone or the Fifth Milestone is not achieved, as described in Sections 9(b)(i), 10(b)(i) and 11(b) below.

e. Other Provisions as to Site. The Site Purchase Agreement will contain such other provisions as AAW and MWD may mutually agree.

3. Plant.

a. Completion of Plant Design.

i. Design/Build Agreement. The Parties acknowledge that it is contemplated that, as described in this MOU, the Design/Build Joint Venture (or an affiliate thereof) will be asked to complete the design of the Plant but otherwise will not build the Plant pursuant to the Design/Build Agreement. AAW will seek to make arrangements with the Design/Build Joint Venture (or an affiliate thereof) consistent with the foregoing. In any event, MWD will have no obligation with respect to the Design/Build Agreement. Nothing in this MOU precludes the possibility that the Design/Build Joint Venture (or an affiliate thereof) might otherwise be involved in the construction of the Plant, such as by bidding for the award of the construction contract, by being retained by one or more of the Parties in the role of Project Coordinator, construction-manager-at-risk, contract administrator or some other capacity, or by providing other services or goods.

ii. Completion of Plant Design Documents. As soon as practicable after the First Milestone, AAW will request that the Design/Build Joint Venture (or an affiliate thereof) complete the design of the Plant. If the Design/Build Joint Venture (or its affiliate) will not so complete the design of the Plant, the Third Milestone and the Fourth Milestone will be adjusted by mutual agreement of the Parties as contemplated in Section 12(c), and AAW will retain another competent design and engineering professional to complete the design of the Plant. The agreement with such other professional will contain warranties that are customary in design agreements, and AAW will provide MWD with the opportunity to review the agreement prior to execution by AAW. In any event, the design of the Plant will be completed in a manner that will enable the construction work for the Plant to be competitively bid as described in Section 3(c)(i), to the extent required by law. In connection with the completion of the design of the Plant, AAW will permit a representative of MWD to participate in discussions regarding such completion and to review and comment on the drafts thereof. In any event, AAW will cause the design of the Plant to be completed by the Second Milestone.

b. Purchase of Plant Design.

i. Plant Design Purchase Agreement. On or before the Second Milestone, AAW and MWD will enter into an agreement providing for the transfer of the Plant Design Documents to MWD by AAW (the "Plant Design Purchase Agreement"). The Plant Design Purchase Agreement will provide for, among other things, the matters described in the following paragraphs (ii) through (vi).

ii. Plant Design Purchase Price.

A. Cost Basis. The purchase price for the Plant Design Documents ("Plant Design Purchase Price") will be the reasonable costs paid or incurred by AAW in development of the Plant (including internal costs and overhead charged to the design project and including costs of having the Plant Design Documents completed in a manner suitable for requesting bids for the construction work as described in Section 3(c)(i)), which costs are deemed to be not less than \$4,500,000 and not more than \$5,300,000. AAW will at its own expense pay any costs in excess of the agreed Plant Design Purchase Price that are incurred prior to MWD's purchase of the Plant Design Documents. MWD will have the right to verify such costs prior to the closing of the purchase, including conducting such audits of those costs as MWD may deem necessary. In no event will the Plant Design Purchase Price include any amounts identified as "delay charges" on invoices to White Tanks Joint Venture for the three months of March, April and May, 2005.

B. Cash Consideration. The price will be payable in cash in full at the closing of the purchase of the Plant Design Documents.

iii. Closing of Design Purchase. To facilitate the timely implementation of the competitive-bidding process described in Section 3(c)(i), the closing of the purchase of the Plant Design Documents will occur on completion of the design of the Plant.

iv. Warranties. At the closing of the purchase, AAW will cause all warranties from the design professional to be assigned to MWD (and, if necessary, will procure

the consent of the design professional to such assignment) so that MWD, as the owner of the Plant Design Documents, will be entitled to the benefit of all warranties with respect to the Plant Design Documents as though MWD were the original owner of the Plant Design Documents.

v. Repurchase of Plant Design Documents. The *Plant Design Purchase Agreement* (or an ancillary agreement) will provide that AAW will repurchase the Plant Design Documents for the Plant Design Purchase Price if the Third Milestone, the Fourth Milestone or the Fifth Milestone is not achieved, as described in Sections 9(b)(i), 10(b)(i) and 11(b).

vi. Other Provisions as to Plant Design. The *Plant Design Purchase Agreement* will contain such other terms and provisions as AAW and MWD may mutually agree.

c. Construction; Project Coordination Agreement. On or before the Second Milestone, MWD and AAW will enter into an agreement pertaining to coordination of the construction work with respect to the Plant (the "Project Coordination Agreement"). The *Project Coordination Agreement* will provide that, among other things:

i. Awarding of Construction Contract. The construction work for Phase IA will be pursuant to a single contract awarded by a competitive-bid process administered by MWD in consultation with AAW. In consultation with AAW, MWD will:

A. Prepare the request for proposals relating to the contract for the construction work.

B. On or before the Third Milestone, issue the request for proposals.

C. Review the bids.

D. Approve the successful bidder.

E. On or before the Fourth Milestone, make the final award of the contract to the successful bidder.

ii. Retention of Project Coordinator. The Parties will cause the retention of a third-party engineer or other person (the "Project Coordinator") to assist MWD in overseeing the activities and work of the contractor. To the extent required by law, the Project Coordinator will be selected through the use of a competitive-bid process, in which case the process will be as described in paragraph (i) above.

iii. Cooperation. The *Project Coordination Agreement* will specify:

A. procedures for meetings among the Parties and the Project Coordinator and for requesting and granting consents and approvals (including when a party is deemed to have approved an item if a party does not timely respond to a request), and

B. a dispute resolution process, including:

(1) the right of MWD to direct certain actions pending resolution of a dispute so as to avoid costs that would otherwise be incurred in connection with a delay, except in cases where the dispute pertains to matters that could affect the operability of the Facility or the quality of water treated and delivered by the Facility, and

(2) a mechanism for sharing of costs attributable to any delay resulting from a dispute.

iv. Applicability to Multiple Phases. The *Project Coordination Agreement* will be applicable to Phase IA of the Plant and, as long as the *Operation and Maintenance Agreement* is in effect, subsequent phases of the Plant.

v. Project Coordination Expense. MWD will reimburse AAW as requested from time to time by AAW for the reasonable salary and overhead costs associated with the time devoted by one employee of AAW in connection with the project coordination. Such costs will be calculated by applying an hourly rate to the time so expended by such employee.

vi. Other Provisions as to Project Coordination. The *Project Coordination Agreement* will contain such other provisions as AAW and MWD may mutually agree.

vii. Completion Date. The Parties acknowledge that it is desirable for the Plant to have been completed and placed in operation prior to the summer of 2008, so as to meet the water needs of AAW and other members of the community and to mitigate usage of groundwater.

4. Pipeline.

a. Initial Pipeline Segment.

i. Construction of Initial Segment. AAW will complete construction of the initial segment of the Pipeline which is currently under construction and will cause such completion to occur no later than the Fifth Milestone. The size, alignment and configuration of that initial segment are depicted on Exhibit C.

ii. Pipeline Purchase Agreement. On or before the Second Milestone, AAW and MWD will enter into an agreement providing for the sale of the initial segment of the Pipeline to MWD by AAW (the "Pipeline Purchase Agreement"). The *Pipeline Purchase Agreement* will provide that, among other things:

A. Pipeline Purchase Price. The purchase price for the initial segment of the Pipeline (the "Pipeline Purchase Price") will be an amount equal to the reasonable design and construction costs paid or incurred by AAW in connection with such construction (including internal costs and overhead charged to the project). MWD will have the right to verify such costs to its reasonable satisfaction, including conducting such audits of those costs as MWD may deem necessary.

B. Closing of Pipeline Purchase. The closing date for the sale of the initial segment of the Pipeline will be a date that is on or before the Fifth Milestone. The Parties contemplate that such closing will be coordinated with the completion of the Plant so as to avoid, if possible, any delay in commencing water deliveries under the *Treatment Facility Capital Lease*.

C. Warranties. At the closing of the purchase, AAW will cause all warranties from the contractors to be assigned to MWD (and, if necessary, will procure the consent of the contractors to such assignment) so that MWD, as the owner of the initial segment of the Pipeline, will be entitled to the benefit of all warranties with respect to the initial segment of the Pipeline as though MWD were the original owner of the initial segment of the Pipeline.

D. Other Provisions as to Pipeline Purchase. The *Pipeline Purchase Agreement* will contain such other provisions as AAW and MWD may mutually agree.

iii. Commission Approval. The Parties acknowledge that the transfer of the initial segment of the Pipeline from AAW to MWD will be conditioned on approval of such transfer by the Commission. If Commission approval is not timely obtained, AAW will remain the owner of the initial segment of the Pipeline and enter into a water-wheeling agreement with MWD regarding transporting of water through such segment.

b. Additional Segment.

i. Design of Additional Segment. On or before the Second Milestone, AAW and MWD will enter into an agreement providing for the transfer of the Pipeline Design Documents to MWD by AAW (the "*Pipeline Design Purchase Agreement*"). The *Pipeline Design Purchase Agreement* will provide that, among other things:

A. Pipeline Design Purchase Price. The purchase price for the Pipeline Design Documents ("*Pipeline Design Purchase Price*") will be the reasonable costs paid or incurred by AAW in development of the additional segment of the Pipeline which will connect the initial segment of the Pipeline to the Plant (including internal costs and overhead charged to the design project for the additional segment but not for the initial segment). MWD will have the right to verify such costs to its reasonable satisfaction, including conducting such audits of those costs as MWD may deem necessary.

B. Closing of Pipeline Design Purchase. The closing date for the sale of the Pipeline Design Documents will be a date that enables construction of the additional segment of the Pipeline to be completed as contemplated in clause (ii) below.

C. Other Provisions as to Pipeline Design. The *Pipeline Design Purchase Agreement* will contain such other provisions as AAW and MWD may mutually agree.

ii. Construction of Additional Segment. MWD will complete construction of the additional segment of the Pipeline on or before the Fifth Milestone. The size, alignment and configuration of that additional segment (which will generally run along Cactus

Road from the Plant connection point to Citrus Road) are depicted on Exhibit C. The Parties contemplate that such additional segment of the Pipeline will be constructed pursuant to a competitive-bidding process, in which case the process will be described in Section 3(c)(i), and that construction of such segment will be governed by the *Project Coordination Agreement* (or a similar agreement addressing, as to such segment, the same matters described in Section 3(c)).

c. Pipeline Connection Agreement. On or before the Second Milestone, AAW and MWD will enter into an agreement permitting AAW to introduce into the Pipeline potable water that has been pumped from wells owned or controlled by AAW (the "Pipeline Connection Agreement"). The *Pipeline Connection Agreement* will provide that, among other things:

i. Quality. AAW will covenant that such well water will not cause the quality of the water in the Pipeline to not meet safe drinking standards and will indemnify MWD against any loss or liability arising as a result of breach of such covenant.

ii. Wheeling Charge. The Parties will agree on a mutually-acceptable wheeling charge.

iii. Terms of Use. The Parties will discuss the terms of AAW's use of the pipeline, including times of use, priority of uses, available capacity and other terms agreed on by the Parties.

iv. Other Provisions as to Pipeline Connection. The *Pipeline Connection Agreement* will contain such other provisions as AAW and MWD may mutually agree.

5. Operation and Maintenance.

a. Operation and Maintenance Agreement. On or before the Second Milestone, American Water Services (or an affiliate thereof) and MWD will enter into an agreement pertaining to the operation and maintenance of the Facility (the "Operation and Maintenance Agreement"). If American Water Services is not to be such operator, MWD will have the right to approve the identity of any affiliate of American Water Services proposed as the operator under the *Operation and Maintenance Agreement*, and, in conjunction therewith, to consider the affiliate's financial wherewithal, experience and reputation, and, if necessary, the obligations of such affiliate will be guaranteed by American Water Services.

b. O&M Fee. The fee to be paid to AAW by MWD for such operation and maintenance services (the "O&M Fee") will be as generally described in Exhibit D.

c. Term of O&M Agreement. The initial term of the *Operation and Maintenance Agreement* will be ten (10) years. Provision will be made for extension of the term for an additional five (5) years by mutual agreement of the Parties.

d. Standards of Performance. The *Operation and Maintenance Agreement* will obligate American Water Services to operate the Plant in a manner that will enable MWD to comply with all water treatment obligations on its part under the Treatment Facility Capital

Lease and any and all of the *Water Treatment Service Agreements* that have been executed at the time the *Operation and Maintenance Agreement* is executed.

e. Other Provisions. The *Operation and Maintenance Agreement* will contain such other provisions as AAW and MWD may mutually agree.

6. Water Supply.

a. Treatment Facility Capital Lease. On or before the Second Milestone, AAW and MWD will enter into an agreement regarding the provision by MWD to AAW, and the purchase by AAW from MWD, of water treatment service pertaining to treatment of initially 7.5 MGD (the "Treatment Facility Capital Lease"). The *Treatment Facility Capital Lease* will provide that, among other things:

i. Capital Lease Payment Formula. The price to be paid by AAW to MWD for the water treatment service will be based on a formula which allocates to AAW only a proportionate amount of reasonable capital costs and operational costs of the Facility (based on the ratio that the amount of water for which AAW has subscribed bears to the total Plant capacity). Such allocation will conform with the formula described in Exhibit E and be otherwise mutually agreeable to AAW and MWD. AAW will have the right to verify such costs to its reasonable satisfaction, including conducting such audits of those costs as AAW may deem necessary.

ii. Term of Capital Lease. The initial term of the *Treatment Facility Capital Lease* will be forty (40) years. AAW will have a right to renew the agreement for an additional forty (40)-year period, provided AAW is current in its payment obligations under the agreement and is otherwise not in material default under the agreement.

iii. Reservation of Plant Capacity. MWD will reserve capacity of the Plant in a manner such that AAW will have available to it 50 MGD of the Plant's projected ultimate capacity of 80 MGD. MWD will not expand the Plant's capacity for the benefit of third parties if doing so would jeopardize such reservation of 50 MGD for AAW. The Parties will discuss having the reserved amount reduced if AAW's long-term master plan shows that AAW's need for reservation of 50 MGD has been commensurately reduced due to either (A) land in AAW's service area that had been projected to be served by potable water from the Plant becomes dedicated to public use in a manner that causes such land to no longer be available for development for residential or commercial purposes, or (B) AAW develops alternate sources of potable water that AAW intends to use to serve land in AAW's service area that theretofore had been projected to be served by potable water from the Plant.

iv. Connection of Alternate Pipeline. If AAW deems it necessary or appropriate to cause the construction of a pipeline for delivery of water to the Plant for purposes of having such water treated at the Plant and then delivered to AAW pursuant to the *Treatment Facility Capital Lease* or otherwise, MWD will (a) grant AAW such rights-of-way as are necessary to enable such pipeline to cross MWD's Beardsley Canal (but not to parallel such canal), (b) allow such pipeline to be connected to the Plant so as to accomplish such purpose and cooperate with AAW in constructing such a connection and placing the connection in service,

and (c) treat water delivered by means of such pipeline and deliver the treated water to AAW in accordance with the *Treatment Facility Capital Lease*.

v. Expansion of Plant. MWD will cause the capacity of the Facility to be expanded as and when requested by AAW at any time and from time to time, provided AAW is current in its payment obligations under the *Treatment Facility Capital Lease*. AAW will have no obligation to request an expansion. In addition, MWD can initiate an expansion, but only if the expansion will not interfere with or undermine the reservation rights of AAW as described in clause (iv) above. The Parties acknowledge that construction work with respect to expansion of the Facility's capacity will be subject to competitive bidding if and to the extent required by law. AAW will have the right to expand the Facility's capacity (and to own and operate such expansions) in the event of MWD's noncompliance with a request to expand the Facility's capacity, and MWD and AAW will coordinate the operation of the Facility and the expansion, respectively, as well as the usage of the Site, so that both the Facility and the expansion are able to operate in an optimal manner. In no event will MWD be required to assume any financial risks associated with uncontracted-for capacity created by an expansion made at AAW's request.

vi. Facility Purchase.

A. No Encumbering of Facility. MWD will not encumber or sell the Facility, except for the lien arising from MWD's financing or refinancing of Facility construction costs.

B. Right of Purchase. During the term of the *Treatment Facility Capital Lease*, MWD will not sell or otherwise transfer or dispose of the Facility except as described in this paragraph. AAW will have the right to purchase the Facility if MWD notifies AAW that MWD no longer desires to own the Facility or to otherwise be engaged in the operation of the Facility. In such a case, AAW will have the right to purchase the Facility for the price described in paragraph 5 of Exhibit E. If AAW does not exercise its right to purchase the Facility within sixty (60) days, MWD will have the opportunity to proceed with trying to sell the Facility to a third party, provided (A) the third party assumes and agrees to be bound by all agreements between MWD and AAW pertaining to ownership and operation of the Facility, but excluding the *AAW Water Wheeling Agreement* and the *Interim Well-Water Supply Agreement*, and (B) such purchase is consummated within eighteen (18) months after AAW elects not to purchase the Facility. The right to repurchase will be solely for the benefit of the holder of the Agua Fria District CC&N and will not be assignable by AAW to any parties apart from the CC&N. Notwithstanding the foregoing provisions of this paragraph, in no event will MWD sell or otherwise transfer or dispose of the Facility prior to the time at which AAW is leasing at least 13.5 MGD treatment capacity from MWD.

vii. Other Provisions as to Water Treatment. The *Treatment Facility Capital Lease* will contain such other provisions as AAW and MWD may mutually agree.

b. Water Treatment Service Agreements with Other Users. It is contemplated that other users of the Facility (in addition to AAW) will sign *Water Treatment Service Agreements* (and related *Water Wheeling Agreements*) with MWD and that, initially,

such other users will be the City of Goodyear and Arizona Water Company. Those *Water Treatment Service Agreements* will be on such terms and conditions as MWD elects, subject to the requirement that such *Water Treatment Service Agreements* do not interfere with or undermine the reservation, connection and expansion rights of AAW as described in clauses (iv) through (vi) of Section 6(a). Such *Water Treatment Service Agreements* will not be subject to approval by AAW.

c. Interim Well-Water Supply Agreement. On or before the Second Milestone, MWD and AAW will enter into the *Interim Well-Water Supply Agreement*, substantially in the form attached as Exhibit F.

d. Retention of Ownership of CAP Allocations. The transactions contemplated by this MOU do not (and will not require) that a Party assign or otherwise transfer any Central Arizona Project ("CAP") allocations held by such Party.

7. District Landowner Credit.

a. Intent and Methodology. It is the intent of MWD, in the exercise of its governmental functions, to provide a benefit to landowners within MWD (including customers of AAW) to reflect, among other things, the economic benefits to MWD of the transactions contemplated by this MOU and, in connection therewith, to utilize the billing services of AAW (or such other means as the District may determine appropriate) to pass through a District Landowner Credit to such landowners who are also customers of AAW. MWD (with its financial advisers) will develop a methodology for the desired amount of the District Landowner Credit.

b. Application to Commission. On or before the Second Milestone, in a filing which is contemplated to include an executed copy of this MOU and drafts of the Facility Agreements, AAW will apply to the Commission for approval of the concept of AAW's cooperation with MWD as a mechanism for implementation of the District Landowner Credit. The Parties acknowledge that the Commission might determine not to approve such cooperation by AAW.

c. Water Credit Guidelines. If the Commission approves AAW's cooperation with MWD as a mechanism for implementation of the District Landowner Credit, MWD and AAW will develop written guidelines, protocols, formulae and procedures for the calculation and implementation of the District Landowner Credit, including the means by which MWD will deliver funds to AAW if MWD, in its discretion, desires that a District Landowner Credit be provided (inasmuch as funds provided by MWD will be the sole basis for the District Landowner Credit) ("Water Credit Guidelines"). AAW acknowledges that the determination of the amount of any District Landowner Credit from time to time is a matter that must remain within the discretion of MWD's Board.

8. Second Milestone.

a. Conditions to Second Milestone. On or before the Second Milestone (as defined in Exhibit A), the Parties will cause all of the following to have occurred:

i. Commission Pre-Approval of Capital-Lease Treatment. As part of the filing described in Section 7(b), AAW will have applied to the Commission for (A) pre-approval of capital-lease treatment for the *Treatment Facility Capital Lease*, and (B) pre-approval of the concept of a surcharge which would include costs associated with depreciation, interest and adequate return on equity related to the *Treatment Facility Capital Lease*, the amount of which will be determined in a subsequent proceeding, and the Commission will have granted the requested approvals.

ii. Execution of Facility Agreements. The following agreements (the "Facility Agreements") will have been signed by MWD and AAW (or, in the case of the *Operation and Maintenance Agreement*, by American Water Services or an affiliate thereof):

- A. *Site Purchase Agreement.*
- B. *Plant Design Purchase Agreement.*
- C. *Project Coordination Agreement.*
- D. *Operation and Maintenance Agreement.*
- E. *Pipeline Purchase Agreement.*
- F. *Pipeline Design Purchase Agreement.*
- G. *Pipeline Connection Agreement.*
- H. *Treatment Facility Capital Lease.*
- I. *Interim Well-Water Supply Agreement.*

iii. Execution of Agreements with Other Users. MWD will either (A) have entered into *Water Treatment Service Agreements* with other users, which agreements are as described in Section 6(b) and which collectively (when combined with the initial amount of water subscribed by AAW as described in Section 6(a)) account for at least 13.0 MGD, or (B) have notified AAW in writing that MWD desires to proceed with the other transactions contemplated by this MOU notwithstanding the absence of such agreements with other users (but this latter alternative will be available to MWD only if the alternative will have no adverse financial impact on AAW).

b. Effect of Failure to Meet Second Milestone. If any of the events described in paragraph (a) above has not occurred on or before the Second Milestone, this MOU will terminate, and the Parties will have no obligation or liability under this MOU.

9. Third Milestone.

a. Conditions to Third Milestone. On or before the Third Milestone (as defined in Exhibit A), the Parties will cause all of the following to have occurred:

i. Site. As described in Section 2(c), the Site will have been conveyed to MWD by AAW pursuant to the *Site Purchase Agreement*.

ii. Design. As described in Section 3(a), the Plant Design Documents will have been completed by AAW, and, as described in Section 3(b)(iii), the Plant Design Documents will have been conveyed to MWD by AAW pursuant to the *Plant Design Purchase Agreement*.

iii. RFP. As described in Section 3(c)(i), the request for proposals for construction of the Plant will have been issued.

b. Effect of Failure to Meet Third Milestone. If any of the events described in paragraph (a) above has not occurred on or before the Third Milestone:

i. Reconveyance. The Plant Design Documents and the Site (together with the initial segment of the Pipeline, as well as the Pipeline Design Documents, if such items have theretofore been transferred to MWD) will be transferred back to AAW by MWD, and AAW will refund in full to MWD the purchase price for the Plant Design Documents and the Site (and, if applicable, for the initial segment of the Pipeline and the Pipeline Design Documents), and

ii. Termination. This MOU and the Facility Agreements will terminate, and the Parties will have no obligation under this MOU or the Facility Agreements.

10. Fourth Milestone.

a. Conditions to Fourth Milestone. On or before the Fourth Milestone (as defined in Exhibit A), the Parties will cause the following events to have occurred:

i. Construction Contract. As described in Section 3(c)(i), one or more bids for construction of the Plant will have been received, and the construction contract for such work will have been awarded.

ii. MWD Financing. MWD will have closed its financing for construction of the Plant, if MWD deems such financing to be necessary.

b. Effect of Failure to Meet Fourth Milestone. If any of the events described in paragraph (a) has not occurred on or before the Fourth Milestone:

i. Reconveyance. The Plant Design Documents and the Site (together with initial segment of the Pipeline, as well as the Pipeline Design Documents, if such items have theretofore been transferred to MWD) will be transferred back to AAW by MWD, and AAW will refund in full to MWD the purchase price for the Plant Design Documents and the Site (and, if applicable, for the initial segment of the Pipeline and the Pipeline Documents).

ii. Termination. This MOU and the Facility Agreements will terminate, and the Parties will have no obligation under this MOU or the Facility Agreements.

11. Fifth Milestone.

a. Conditions to Fifth Milestone. On or before the Fifth Milestone (as defined in Exhibit A), the Parties will cause the following events to have occurred:

i. Initial Pipeline Segment. As described in Section 4(a)(ii)(B), the initial segment of the Pipeline will have been conveyed by AAW to MWD.

ii. Additional Pipeline Segment. As described in Section 4(b)(ii), the additional segment of the Pipeline will have been constructed by MWD.

b. Effect of Failure to Meet Fifth Milestone. If the event described in clause (i) of paragraph (a) has not occurred on or before the Fifth Milestone, MWD will have any rights available at law or equity, including the right to seek and collect damages from AAW resulting from any resulting delay in the Start-Up of the Plant, and if the event described in clause (ii) of paragraph (a) has not occurred on or before the Fifth Milestone, AAW will have any rights available at law or equity, including the right to seek and collect damages from MWD resulting from any resulting delay in the Start-Up of the Plant.

12. Limited Extension of Milestones.

a. Unilateral Extension as to Any Milestone. On or before a Milestone, either Party has the right to notify the other Party that such Party elects to extend such Milestone for a period of thirty (30) days. Such election can be made by a Party only once with respect to each Milestone. Such election (or the failure so to elect) does not preclude the Party from exercising the election as to a subsequent Milestone. Such election does not preclude the other Party from exercising the election with respect to the extended Milestone. The Parties acknowledge that, if both Parties were to exercise their respective rights to extend a Milestone, such elections would have the cumulative effect of extending the Milestone for a total of sixty (60) days.

b. Right to Cure. If a Milestone occurs and the conditions pertaining to the Milestone have not been satisfied (as described in Section 8(a), 9(a), 10(a) or 11(a), as applicable), a Party has the right to notify the other Party within five (5) days after the Milestone that such Party is diligently attempting to cause all pertinent conditions to be satisfied and that such Party reasonably believes that such satisfaction is probable. Notwithstanding the foregoing, a Party will not have the right to give such notice if the Party previously elected to extend the Milestone under paragraph (a) above. A Party is entitled to exercise such right only once with respect to each Milestone. If such a notice is duly given, the Milestone will be extended for an additional thirty (30) days.

c. Mutual Agreement. The Parties also may (but are not obligated to) mutually agree in writing to amend or extend a Milestone.

d. No Effect on Subsequent Milestones. Extension of a Milestone does not cause a subsequent Milestone to be extended.

13. Representatives.

a. Authorized Representatives. Each Party will designate at least one individual officer or employee who will be its representative ("Representative"). A Party may designate more than one Representative. The designation may be changed from time to time. The designation must be made in a writing delivered to the other Party.

b. Authority to Act. The Representative is authorized to act on behalf of the Party in performing the provisions of this MOU.

c. No Release. Each Party is responsible for the acts or omissions of its Representative(s). The designation of a Representative by a Party does not release the Party from responsibility for performance of its obligations under this MOU.

14. Notices. Except as otherwise specified in this MOU, any notice, demand, request or other communication required or authorized by this MOU to be given in writing to a Party must be either (a) personally delivered, (b) mailed by registered or certified mail (return receipt requested), postage prepaid, (c) sent by overnight express carrier, or (d) sent by telecopy or electronic mail, in each case at the following address:

To MWD addressed as follows:

For personal delivery:

Maricopa County Municipal Water Conservation District Number One
14825 West Grand Avenue
Surprise, Arizona 85374

For mail delivery:

Maricopa County Municipal Water Conservation District Number One
P.O. Box 900
Waddell, Arizona 85355-0900

With a copy to:

Ryley, Carlock & Applewhite, P.A.
Attention: Sheryl A. Sweeney, Esq.
One N. Central Avenue, Suite 1200
Phoenix, Arizona 85004-4417

or to such other address as MWD may advise AAW in writing, and to AAW at:

Arizona-American Water Company
Attn: Robert Kuta, Vice President, Service Delivery
19820 North 7th Street, Suite 201
Phoenix, Arizona 85024

With a copy to:

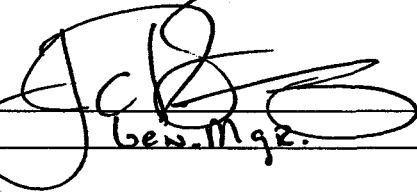
Gallagher & Kennedy, P.A.
Attn: Terence W. Thompson, Esq.
2575 East Camelback Road
Phoenix, Arizona 85016

or to such other address as AAW may advise MWD in writing. The designation of such person and/or address may be changed at any time by either Party upon written notice given under this Section. All notices, demands, requests or other communications sent pursuant to this Section will be deemed received (i) if personally delivered, on the business day of delivery, (ii) if sent by telecopy or electronic mail before noon (12:00 p.m.) Phoenix time, on the day sent if a business day or, if such day is not a business day or if sent after noon (12:00 p.m.) Phoenix time, on the next business day, (iii) if sent by overnight express carrier, on the next business day immediately following the day sent, or (iv) if sent by registered or certified mail, on the earlier of the third business day after the day sent or when actually received. Any notice by telecopy or electronic mail will be followed by delivery on the next business day by overnight express carrier or by hand.

15. Nonbinding Nature. Each Party will bear its own expenses incurred in connection with the negotiation, execution and delivery of this MOU and any of the documents described in this MOU, including fees and costs of any advisers retained by such Party. This MOU reflects the intention of the Parties with respect to the basis for proceeding with further discussions, negotiations and definitive agreements with respect to the transactions described in this MOU. This MOU is not binding on and does not impose any obligation or liability on any of the Parties and does not obligate any Party to proceed with any of the transactions described in this MOU.

IN WITNESS WHEREOF, the Parties hereto have executed this Memorandum as of the date first above written.

MARICOPA COUNTY MUNICIPAL WATER
CONSERVATION DISTRICT NUMBER ONE,
a political subdivision of the State of Arizona

By: 
Its: Gen. Mgr.

ARIZONA-AMERICAN WATER COMPANY,
an Arizona corporation

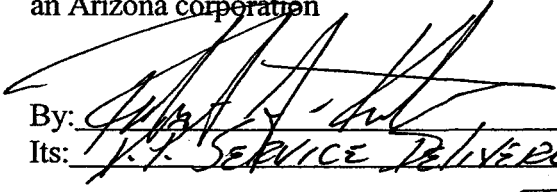
By: 
Its: J. F. SERVICE DELIVERY

EXHIBIT A
TO
MEMORANDUM OF UNDERSTANDING
DEFINITIONS

“AAW” means Arizona-American Water Company, an Arizona corporation.

“AAW Water Wheeling Agreement” means the *Nondistrict Water Wheeling and Exchange Agreement*, dated as of June 27, 2005, between MWD and AAW.

“affiliate” means any person (other than an individual) that directly or indirectly controls, is controlled by, or is under common control with, another person. For purposes of this definition, “control” means possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether by contract or otherwise.

“American Water Services” means American Water Services Operations and Maintenance, Inc., a Texas corporation.

“Arizona Water Company” means Arizona Water Company, an Arizona corporation.

“CAP” means Central Arizona Project.

“Commission” means the Arizona Corporation Commission.

“Design/Build Agreement” has the meaning set forth in Recital B.

“Design/Build Joint Venture” has the meaning set forth in Recital B.

“District Landowner Credit” means a credit or other regulatory treatment benefiting potable water customers within AAW’s service area who reside within MWD’s geographical boundaries.

“Facility” means, collectively, the Site, the Plant and the Pipeline.

“Facility Agreements” has the meaning set forth in Section 8(a)(ii).

“Fifth Milestone” means the date on which the Plant is (or, after appropriate testing, is capable of being) placed in operation.

“First Milestone” has the meaning set forth in Recital F.

“Fourth Milestone” means one hundred twenty (120) days after the Third Milestone, or such other date as the Parties may mutually agree in writing.

“herein,” “hereinafter,” “hereof” and “hereunder” refer to this MOU as a whole and not merely to a subdivision in which such words appear, unless the context otherwise requires. The singular will include the plural, and the masculine gender will include the feminine and neuter, and vice versa, unless the context otherwise requires.

“includes” and “including” denote a partial definition, by way of illustration and not by way of limitation.

“Interim Well-Water Supply Agreement” has the meaning set forth in Section 6(c).

“MGD” means million gallons per day.

“MOU” means this Memorandum of Understanding dated as of June 27, 2005, between MWD and AAW, including all exhibits and any other attachments, as amended from time to time.

“MWD” means the Maricopa County Municipal Water Conservation District Number One, a political subdivision of the State of Arizona.

“Milestones” means the First Milestone, the Second Milestone, the Third Milestone, the Fourth Milestone and the Fifth Milestone.

“O&M Fee” has the meaning set forth in Section 5(b).

“Operation and Maintenance Agreement” has the meaning set forth in Section 5(a).

“Parties” means MWD and AAW.

“person” means an individual or an entity. For purposes of this definition, “entity” means a corporation, association, company, business trust, trust, estate, partnership, joint venture, two or more persons having a joint or common economic interest, any person other than an individual, and any governmental body.

“Phase IA” means the initial phase of the Plant, which phase is contemplated to have a rated capacity of 13.5 MGD.

“Pipeline” has the meaning set forth in Recital C. The term includes both the initial segment of the Pipeline described in Section 4(a)(i) and the additional segment of the pipeline described in Section 4(b)(ii).

“Pipeline Connection Agreement” has the meaning set forth in Section 4(c).

“Pipeline Design Documents” means the documents embodying the plans and specifications for construction of the additional segment of the Pipeline which will connect the initial segment described in Section 4(a)(i) to the Plant.

“Pipeline Design Purchase Agreement” has the meaning set forth in Section 4(b)(i).

“Pipeline Design Purchase Price” has the meaning set forth in Section 4(b)(i)(A).

“Pipeline Purchase Agreement” has the meaning set forth in Section 4(a)(ii).

“Pipeline Purchase Price” has the meaning set forth in Section 4(a)(ii)(A).

“Plant” has the meaning set forth in Recital B.

"Plant Design Documents" means the documents embodying the plans and specifications for construction of the Plant.

"Plant Design Purchase Agreement" has the meaning set forth in Section 3(b)(i).

"Plant Design Purchase Price" has the meaning set forth in Section 3(b)(ii)(A).

"Project Coordination Agreement" has the meaning set forth in Section 3(c).

"Project Coordinator" has the meaning set forth in Section 3(c)(ii).

"R&R" means repair and replacement.

"Representative" has the meaning set forth in Section 13(a).

"Second Milestone" means sixty (60) days after issuance by the Commission of its final order containing the pre-approvals described in Section 8(a)(i), or such other date as the Parties may mutually agree in writing.

"Site" has the meaning set forth in Recital A.

"Site Purchase Agreement" has the meaning set forth in Section 2(a).

"Site Purchase Price" has the meaning set forth in Section 2(b)

"Start-Up" means the date on which (1) MWD has received all authorizations (if any) required to provide water treatment and delivery services and to operate the Plant and the Pipeline as contemplated in this MOU; and (2) Substantial Completion has occurred.

"Substantial Completion" means the date determined by MWD on which both (1) the construction of the Plant and the Pipeline has been completed, and (2) MWD has operated the Plant and the Pipeline to ensure, to the satisfaction of MWD, proper function and operation.

"Third Milestone" means sixty (60) days after the Second Milestone, or such other date as the parties may mutually agree in writing.

"Treatment Facility Capital Lease" has the meaning set forth in Section 6(a).

"Water Treatment Service Agreement" means a water treatment service agreement pursuant to which MWD agrees to deliver potable water from and through the Facility to a customer (such as municipality or private water company) for redelivery by such customer to end users of such water, as described in Section 6(b).

"Water Wheeling Agreement" means a nondistrict water wheeling and exchange agreement pursuant to which MWD agrees to wheel or transport (on behalf of the other party or parties to the agreement) water to the Plant through canal or other transportation facilities belonging to MWD. The term includes the *AAW Water Wheeling Agreement*.

EXHIBIT B
TO
MEMORANDUM OF UNDERSTANDING
REAL PROPERTY LOCATION

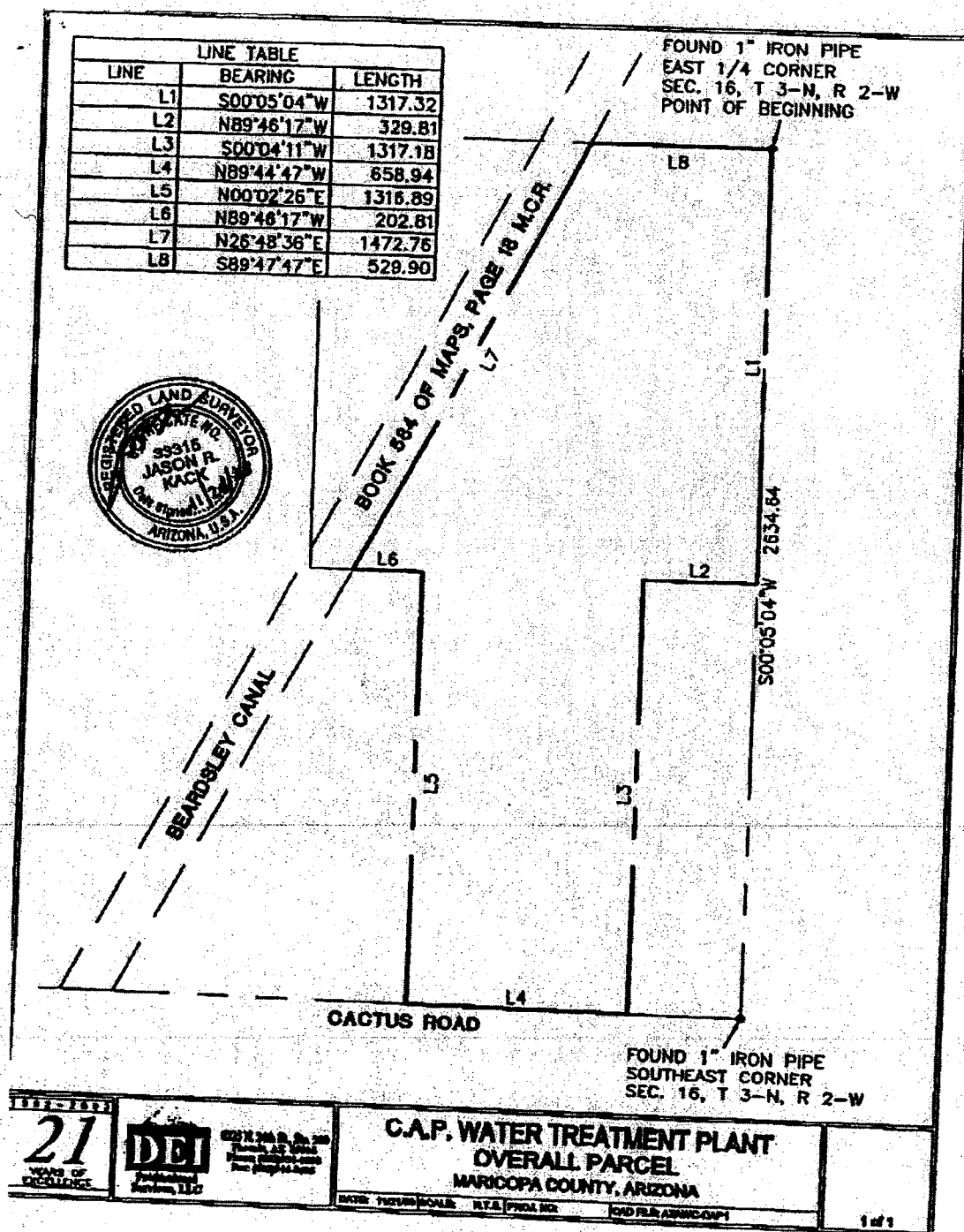
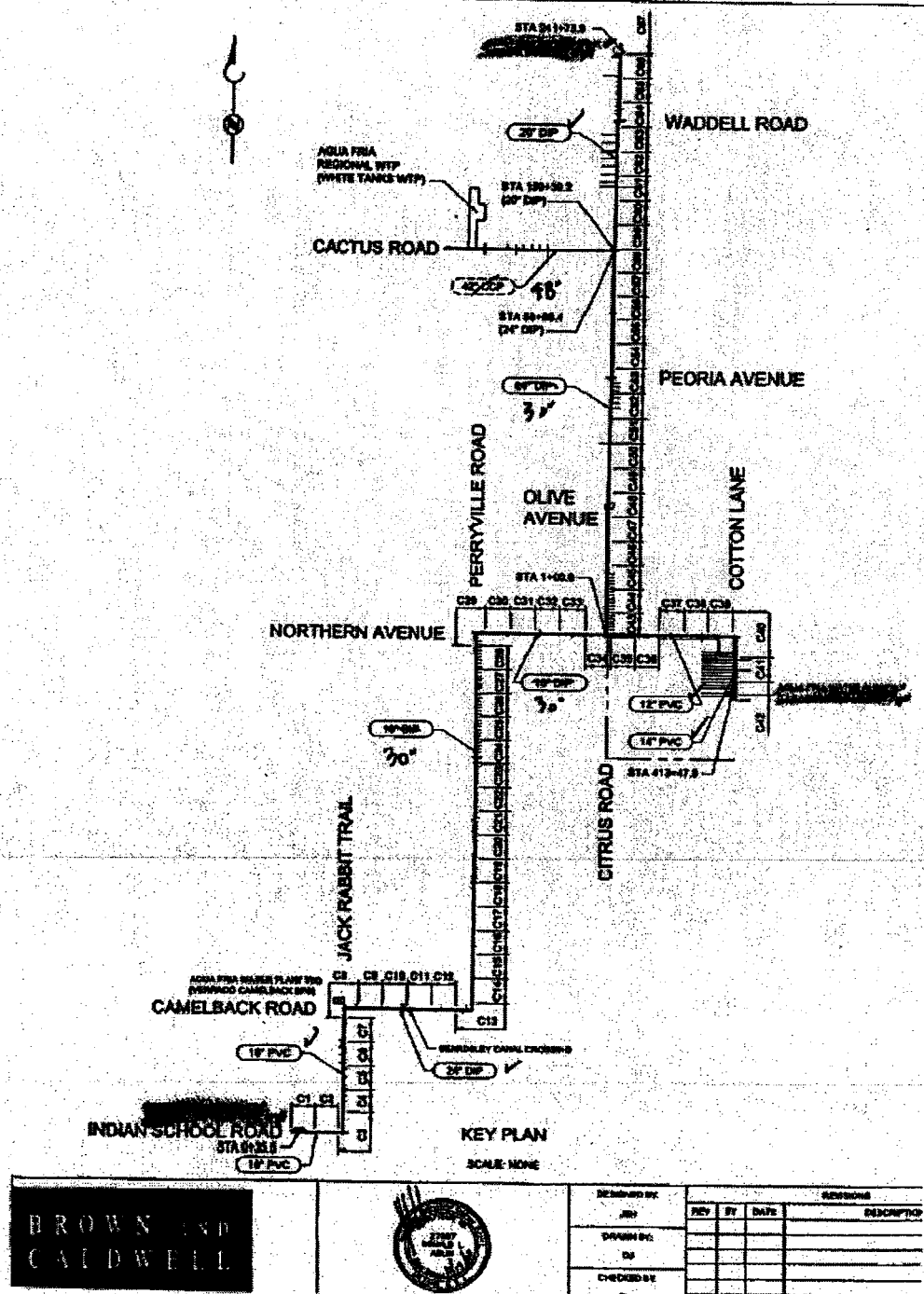


EXHIBIT C **TO** **MEMORANDUM OF UNDERSTANDING** **PIPELINE SIZE, ALIGNMENT AND CONFIGURATION**



**EXHIBIT D
TO
MEMORANDUM OF UNDERSTANDING**

**OPERATION AND MAINTENANCE AGREEMENT –
OUTLINE OF CONTEMPLATED FEE STRUCTURE**

This Memorandum of Understanding has been developed to provide a summary of the terms and conditions contemplated by the Parties to be included in the subsequent Operation and Maintenance Agreement (Agreement) for the operation, maintenance and management of the Facility. The intent of the Agreement will be to provide for the efficient and cost-effective operation and maintenance (O&M) of the Facility over the term of the Agreement with the appropriate allocation of risks between the Parties.

The terms and provisions of the Agreement will comply with the Internal Revenue Service Code of 1986, as amended, including without limitation IRS Revenue Procedure 97-13. Payment of the O&M Fee will be within the specified percentages for fixed and variable as allowed by Revenue Procedure 97-13.

The following presents the “conceptual” approach regarding the general scope of services and the associated fee structure:

1. All costs for management, operation and maintenance (MOM) services will be designated as fixed or variable. Fixed costs include those costs that are relatively constant during a production year and do not vary significantly with a change in the volume of treated water. Variable costs include those costs that vary directly with the volume of water treated and pumped. MOM costs include those costs to be paid directly by the MWD as specifically identified in this Exhibit.

2. The MWD will pay to AWS an O&M Fee for the operation, maintenance, and management services generally identified herein and more fully described in the subsequent Agreement. The O&M Fee will include a Fixed Fee and a Variable Fee as defined below.

3. The Fixed Fee will include:

a. All labor and expenses for management, operation and routine maintenance, except for the costs covered by the Variable Fee, Pass Through Costs and any other cost provisions of the Agreement.

b. Staff and facility support costs including vehicles, telephone and telemetry, water, safety and personnel equipment, landscaping, waste disposal, specialized maintenance etc.(performed in-house by AWS or subcontracted), sampling and specialized testing functions (coli forms, THMs, Metals, VOCs, etc.) (performed in-house by AWS or subcontracted to a licensed and certified laboratory), information technology, and miscellaneous.

A separate monthly fee for the Pre-Operational Period would be developed based on anticipated construction schedule related to supplier training on process equipment, American Water Services (AWS) participation in facility testing and acceptance, etc.

4. The Variable Fee will include:
 - a. Chemicals used in water treatment and distribution;
 - b. Collection, transportation and disposal of water sludges produced in the treatment process.
5. MOM costs include the cost of goods or services to be paid directly by MWD to the vendor, including:
 - a. Electricity and natural gas costs, subject to the maximum utilization guarantee specified in the Agreement.
6. Repair and Replacement (R&R) expenses and activities, distinguished from routine maintenance activities that are included in the Fixed Fee, will be the responsibility of MWD and are described in Exhibit E.

Contractual terms would require use of Computerized Maintenance Management System for verification of mandated service activities, corrective service and asset tracking and would require that AWS keep MWD assets in some high state of "useful remaining" life.

MWD will pay AWS the O&M Fee for the services provided in accordance with the Agreement. The Fixed component and unit costs for the Variable component of the O&M Fee will be established prior to execution of the Agreement. The Fixed Fee will be paid in 1/12th increments during each month of the Contract Year. The Fixed Fee would be adjusted annually on an agreed cost index basis. The chemical and water residuals component of the Variable Fee will be paid by MWD to the AWS based on water production and water sludges generation and the established unit prices for chemicals and water sludges services. AWS will provide base unit prices for the provision of chemicals (dollars/mg treated) and residuals services (dollars/ton) prior to execution of the Agreement. Such unit prices will be adjusted annually in accordance with the agreed upon escalation indices.

EXHIBIT E
TO
MEMORANDUM OF UNDERSTANDING
CAPITAL LEASE PAYMENT FORMULA

The tentative capital lease payment formula is attached. With respect to such formula, the Parties acknowledge:

1. Land. Land will not be treated as a depreciable item.
2. Maintenance Investment. Maintenance Investment is defined as investment in facility assets of a cost of \$50,000 or less per item (subject to consumer price index or similar adjustment) that will allow the Plant to function as designed until the end of the anticipated composite service life. Maintenance Investment will be paid by the operator under the *Operation and Maintenance Agreement*, be reimbursable by MWD, and charged as part of the fixed operation and maintenance charge under the portion of the formula dealing with operating and maintenance costs.
3. Repair and Replacement (R&R) Investment.
 - a. With respect to capital expenditures made by MWD to extend the usable life of the Plant:
 - i. Capitalized R&R is defined as investment in facility assets that will extend the life of the Plant beyond the anticipated composite service life, or any individual R&R investment that exceeds \$50,000 (subject to consumer price index or similar adjustment). An additional capital lease between MWD and AAW and covering such capitalized R&R investment will be established (i) when such investments have in the aggregate reached a cumulative amount of \$500,000, or (ii) otherwise, at intervals of five years.
 - ii. Any capital investment in excess of \$500,000 per item (subject to consumer price index or similar adjustment) in the Plant that results in the expansion of capacity or as a result of implementing improvements needed to meet new or existing regulatory requirements (and that is not covered by clause (i) above) will immediately trigger an additional capital lease to be effective as of the commissioning date of the expansion or improvement. Similarly, any increase in the amount of water to be delivered on a regular basis to AAW from the Plant will immediately trigger such an additional capital lease. Such an additional capital lease may include any outstanding items in clause (i) above. For purposes of calculating the amount to be recouped by MWD in connection with such a capital investment, the capital investment will be deemed to include "carrying costs" analogous to the concept of "interest during construction" applicable to a utility.
 - iii. Each such additional capital lease will be implemented by means of a supplement, addendum or other modification to the Treatment Facility Capital Lease. The Treatment Facility Capital Lease and all such supplements, addenda or other modifications will

together constitute a single agreement. Each such additional capital lease will (a) identify the leased assets with reasonable specificity, (B) specify the capital lease payment applicable to those assets, which payment will be calculated in accordance with the formula set forth in this Exhibit, and (C) specify the lease term applicable to those assets.

b. MWD will have the right to make R&R and other capital investment decisions with respect to the Plant as it deems necessary or prudent, provided such investments comply with industry standards and do not interfere with or undermine the reservation, connection and expansion rights of AAW as described in clauses (iv) through (vi) of Section 6(a). No approval of these capital investment decisions by AAW will be necessary as a condition to the obligation of AAW to share in the costs of such investments, but AAW will be entitled to dispute (in accordance with the dispute-resolution process set forth in the *Treatment Facility Capital Lease* or other applicable agreement) the necessity or prudence of such a decision, the decision's compliance with prudent industry practices (defined below), or the allocation of such costs. In no event will AAW have any responsibility for costs associated with an expansion of the Facility for the benefit of another user of the Facility. "Prudent industry practices" means any of the practices, methods and acts that: (i) at the time that such practice, method or action is employed, and in the exercise of reasonable judgment in light of the facts known at such time, would be expected to accomplish the desired result consistent with applicable law, good business practices, safety, reliability, efficiency and expedition, and (ii) when engaged in are commonly used or approved by prudent water and wastewater treatment industries, regardless of whether subject to public service corporation regulation, operating in the State of Arizona; prudent industry practices are not to be interpreted, construed as or limited to the optimum industry practices, methods or acts, but rather as a range of acceptable practices, methods or acts consistent with the duties and obligations of MWD under any *Water Treatment Service Agreements* by which it is bound.

4. Administration Fee. Provision will be made for payment by AAW to MWD of an annual administration fee, payable in twelve (12) monthly installments. The administration fee will equal 10% of the Facility's projected fixed and variable operations and maintenance costs (whether fixed or variable, including Maintenance expenses referred to above, but excluding R&R expenses) set forth in the budget for such year.

5. Payment After Initial Amortization Period. After the expiration of the amortization term of the lease for a leased asset (factor "n" under "Fixed Capital Lease Payments" on the attached formula), the capital lease payment to be paid by AAW with respect to that asset will become one dollar (\$1.00) per year during any additional period for which AAW leases the asset (instead of the formula-based fixed capital lease payment described in the attachment).

6. Facility Repurchase Price. For purposes of the facility purchase price described in Section 6(a)(vi), the purchase price to be paid by AAW will be the sum of: (a) the original cost to MWD of that portion of the Facility not leased to AAW less the portion thereof that has been or is deemed to have been recovered by MWD from other users of capacity within the Facility (the manner of determining such amount to be determined by the parties and set forth in the Facility Repurchase Agreement); plus (b) an amount calculated in accordance with the following Excel formula:

$$\text{Facility Purchase Price} = \text{Max} \left(B, \text{PMT} \left\{ \frac{1}{r} - \frac{1}{r(1+r)^{n-t}} \right\} \right)$$

Where PMT is calculated as described in the attached capital lease payment formula and:

B = allowance for transaction costs

r = interest rate of the capital lease

n = number of periods in lease amortization term

t = number of lease payments paid to date

Capital Lease Payment Formula

AAW will make two types of payments to MWD for the lease of the White Tank's facility and associated distribution system assets; fixed capital lease payments and operation and maintenance (O&M) expense payments. The amount of these payments will be calculated as follows:

Fixed Capital Lease Payments

Monthly Capital Lease Payment will be calculated as follows:

$$[PMT] / 12$$

Where [PMT] is calculated as:

$$PMT = A[r / (1 - (1 / (1 + r)^n))] * f / h$$

A = original cost of the White Tanks Plant and delivery assets (including utility plant, land, trunk main assets, and capitalized interest).

r = interest rate

n = amortization period of lease

f = AAW's subscribed capacity

h = Total subscribed plant capacity

and r (interest rate) is calculated as:

$$r = (\text{Treasury Bond Rate}) + (\text{Corporate Spread})$$

Where:

Treasury Bond Rate = applicable U.S. Treasury bond rate taken from Bloomberg (or other appropriate authoritative source) one week in advance of lease inception, for a tenure equivalent to the amortization period of the lease using the following boundaries:

Amortization Period of Lease

Treasury Instrument

5 years or less

5-year Treasury bond

More than 5 years but
not more than 10 years

10-year Treasury bond

<u>Amortization Period of Lease</u>	<u>Treasury Instrument</u>
More than 10 years but not more than 15 years	15-year Treasury bond
More than 15 years but not more than 20 years	20-year Treasury bond
More than 20 years but Less than 25 years	25-year Treasury bond
25 years or more	30-year Treasury bond

For purposes of the foregoing, the amortization period of each lease will consist of the weighted average of the useful lives of all assets subject to such lease, based upon the attached schedule of useful lives, presented for each NARUC asset classification category (unless MWD in its discretion consents to an alternative useful life that would be specified by the Commission or generally-accepted accounting principles were AAW the owner of the Facility, in which case such other lives will apply).

If the corresponding Treasury instrument (e.g., the 30-year Treasury bond) is not then in use, the Treasury-Bond Rate will equal the sum of (a) the 10-year Treasury bond rate, plus (b) the average spread that existed between the 10-year Treasury bond rate and the abandoned instrument during the ten years preceding such abandonment.

Corporate Spread = 275 basis points.

If the Internal Revenue Code is amended so that interest on obligations issued by MWD to finance projects of the sort and with the structure contemplated by this MOU will generally not be exempt from federal income tax, r (interest rate) for subsequent leases will be increased to the level necessary for MWD to maintain an equivalent return based upon the taxable rate of interest at which MWD is able to borrow for such projects.

The foregoing formula will be implemented in a manner such that, in instances where the amortization period for a lease is less than the term of the lease, AAW's obligations after the amortization period has expired will be limited to the payment of one dollar (\$1.00) per year for the remaining term of the lease and any additional period for which AAW leases the asset, hence preserving the right under generally accepted accounting principles (GAAP) to depreciate over the useful life of the assets.

Operation & Maintenance Payments

Monthly O&M Charge will be calculated as follows:

[C] + [D], where

[C] = Fixed Operation & Maintenance Charge

[D] = Variable Operation & Maintenance Charge

Where [C] is calculated as follows:

$$[C] = (m) / 12 \times f / h$$

m = budgeted annual fixed O&M expenditures

And [D] is calculated as follows:

$$[D] = n \times \text{rate}$$

n = User's monthly measured flow in 1,000 gallons

rate = Equal to q / annual estimated flow (expressed as \$ per 1,000 gallons)

q = budgeted annual variable O&M expenditures including electricity and power costs, and sludge disposal costs (including chemicals, hauling, and disposal)

At the end of each year, the amount of O&M payments made by AAW during the year will be compared to the actual O&M expenditures. Any over- or under- payment of O&M by AAW will be reconciled at the end of the year, and will be applied to the next subsequent month's payment.

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

EXHIBIT F
TO
MEMORANDUM OF UNDERSTANDING
FORM OF INTERIM WELL-WATER SUPPLY AGREEMENT

INTERIM WELL-WATER SUPPLY AGREEMENT dated as of _____, 2005 ("Agreement"), between MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE, a municipal corporation and a political subdivision of the State of Arizona ("MWD"), and ARIZONA-AMERICAN WATER COMPANY, an Arizona corporation ("AAW").

RECITAL:

A. Concurrently herewith, MWD and AAW have executed a Memorandum of Understanding (the "MOU") committing the parties to negotiating a series of agreements, whereby MWD will construct a water treatment plant and provide water treatment services to AAW for AAW's Central Arizona Project water and other surface water supplies. If such negotiations are successful, the parties anticipate that the water treatment plant will be operational by 2008.

B. In order to meet anticipated water demand and reduce the necessity of AAW drilling, or requiring developers requesting service from AAW for lands within MWD boundaries to drill, additional wells to provide water service to its customers until the water treatment plant is operational or other alternatives are available to AAW, AAW wishes to purchase an interim supply of groundwater from MWD.

AGREEMENT:

NOW, THEREFORE, the parties agree as follows:

I. Provision of Well-Water.

1.1 General. On the terms and conditions provided in this Agreement, MWD will supply water from certain designated existing wells of MWD. The existing wells of MWD are specified on Exhibit A. From among those existing wells MWD will select wells for upgrading and use under this Agreement, considering the input on technical issues from AAW. The designated wells are referred to in this Agreement as the "MWD Wells."

1.2 Amount of Water.

a. Subject to paragraphs (c) through (h), MWD will, if requested by AAW, supply AAW up to 3 million gallons per day ("MGD") of water for the benefit of landowners in the MWD service area in each of calendar years 2007 and 2008 from the MWD Wells designated as Phase One Wells in Exhibit A hereto.

b. Unless MWD notifies AAW within thirty (30) days after the Second Milestone (as defined in the MOU) that the conditions pertinent to the Second Milestone were not satisfied, then, subject to paragraphs (c), (d), and (e), MWD will, if requested by AAW, supply AAW up to an additional 3 MGD, for a total of up to 6 MGD of water, for the benefit of landowners in the MWD service area in calendar year 2008 from the MWD Wells designated as Phase One Wells and Phase Two Wells in Exhibit A.

c. The parties acknowledge that it is anticipated that, in any particular calendar year, the water will be needed by AAW primarily during the months of May through October and the amount needed by AAW might be less than the amounts set forth above.

d. AAW will request water from MWD under this Agreement only after AAW has made reasonable efforts to provide the maximum amount of water practical or permissible from AAW's own existing wells.

e. MWD and AAW will work cooperatively to schedule water deliveries and to operate the MWD Wells to deliver the water requested by AAW pursuant to this Agreement.

f. If either party receives written notice from a governmental body that the sale of groundwater by MWD to AAW in the manner contemplated by this Agreement violates any statutory provisions or regulations related to the withdrawal and use of groundwater, the parties will meet and confer as to amending this Agreement to remedy the situation and, at the discretion of MWD, MWD will have the right to suspend the supplying of water under this Agreement in whole or in part until the situation has been remedied.

g. With respect to costs incurred by MWD in modifying and connecting the MWD Wells as described in Sections 2.1 and 2.2:

i. If the parties enter into the AAW Bulk Water Supply Service Agreement (as defined in the MOU), MWD will be deemed to have recovered such costs by means of amounts payable under such agreement, and MWD will have no right to otherwise collect such costs from AAW.

ii. Notwithstanding the foregoing, if the parties have not entered into such agreement on or before December 31, 2006, AAW will be obligated to reimburse MWD for such costs in five equal annual installments commencing January 1, 2007, and continuing on each January 1 thereafter, together with interest at the prime rate of Bank One, Arizona, N.A., in effect on January 1, 2007, such interest to accrue on the outstanding balance from January 1, 2007, until paid.

iii. AAW will have the right to inspect and copy the books and records of MWD with respect to the data and supporting documentation for such costs.

h. The annual in-lieu water schedule delivery order submitted by AAW to MWD for calendar years 2007 and 2008 must indicate that AAW will store (and AAW must store) in MWD's groundwater savings facility in each of calendar years 2007 and 2008 not less than 14,161 acre feet of Central Arizona Project (CAP) water. Notwithstanding the foregoing, the requisite storage amount for each year will be 7,620 acre feet of CAP water if the Sun City

groundwater exchange is implemented by AAW. If the submitted order or subsequent amended orders indicate that the requisite amount of water is not being stored, MWD will have the right to notify AAW of such event. If such notice is given, AAW will have 30 days from receipt of the notice to cause the storage order to be in the requisite amount. If AAW fails to so cure the storage deficiency, MWD will have the right to suspend the supplying of water under this Agreement in whole or in part until the situation has been remedied.

1.3 Price of Water. The price for the water supplied by MWD from the MWD Wells to AAW will be an amount based on electrical power allocable to pumping the water from the MWD Wells, calculated at the general service rate (or other applicable rate) then in effect for other non-irrigation customers in the same rate classification applicable to AAW's use.

1.4 Term. The term of this Agreement will begin on _____, 2005 (the "Start Date"), and will terminate on the earlier of (i) the date the water treatment plant is operational and operating or (ii) December 31, 2008. The obligations under Sections 1.2(g), 1.6 and 3.1 will survive termination of this Agreement.

1.5 Water Quality. MWD agrees to provide the water from the MWD Wells on an "as-is" basis, based on the quality of the water indicated by tests performed prior to the Start Date. MWD will be responsible for installation of chlorination facilities. AAW will be responsible for operating and maintenance of the chlorination facilities (and MWD will allow AAW to have access to the MWD Wells at any time and from time to time for such purpose). The point of delivery for the water from MWD to AAW will be the discharge elbow of the well-pump assembly. Any additional treatment cost required due to changes in water quality occurring after initial water quality testing done prior to the Start Date, will be the responsibility of AAW. AAW will be responsible, at its sole cost and expense, for causing such water to meet water-quality standards required under the Safe Drinking Water Act either (i) when taken by MWD from the MWD Wells or (ii) by means of a water-blending plan approved by the Arizona Department of Environmental Quality ("ADEQ") or its designee.

1.6 Indemnity. AAW will indemnify and hold MWD harmless for, from and against all claims, penalties, costs, liabilities, damages or loss of any kind, including reasonable attorneys' fees and costs, arising as a result of or related to the quality of water produced by the MWD Wells and introduced into the AAW system or the use of such water by AAW or others.

II. Preparation of Wells.

2.2 Modification of MWD Wells. MWD will modify the MWD Wells, at MWD's sole cost and expense, to make the MWD Wells appropriate for use as and when contemplated under this Agreement. Such modification will include installing sanitary seals, installing chlorinators, and other work as may reasonably be required by those governmental entities having jurisdiction in order to utilize MWD Wells for the purposes contemplated by this Agreement, but not including water quality treatment.

2.3 Pipeline Connections. To enable the timely supplying of water to AAW from the MWD Wells as and when required under this Agreement, MWD will, at MWD's sole cost and

expense, construct and install pipeline connections from the MWD Wells to mutually agreed points of connection to AAW's water distribution system.

2.4 Source Approval. MWD, in conjunction with AAW's cooperation, will obtain new drinking-water source approvals from Maricopa County and ADEQ if and to the extent necessary to enable the timely supplying of water to AAW from the MWD Wells as and when required under this Agreement.

2.5 Water Quality Testing. To the extent such testing is necessary or desirable for AAW's purposes, AAW will perform such testing, and MWD will allow AAW to have access to the MWD Wells at any time and from time to time for such purpose.

III. General Provisions.

3.2 Arbitration. If any dispute arises under this Agreement, upon written notice from either party to the other, the parties will immediately seek to resolve the dispute by good faith negotiations. If the parties are unable to resolve the dispute in writing within ten business days after the commencement of such good faith negotiations, then the dispute will be submitted to, and finally settled by, arbitration. The arbitration will be conducted in Phoenix, Arizona in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The decision of the arbitrator(s) will be final and non-appealable as between the parties to this Agreement. Judgment on the arbitration award may be entered in any court of competent jurisdiction. Notwithstanding the forgoing, either party may, at its option, seek injunctive relief or other provisional remedies against the other party from any court of competent jurisdiction. Each party to the dispute will bear its respective expenses incurred in respect of the dispute and the costs of the arbitrator(s) will be borne equally by both parties.

3.3 Notices. Except as otherwise specified in this Agreement, any notice, demand, request or other communication required or authorized by this Agreement to be given in writing to a party must be either (a) personally delivered, (b) mailed by registered or certified mail (return receipt requested), postage prepaid, (c) sent by overnight express carrier, or (d) sent by telecopy or electronic mail, in each case at the following address:

To MWD addressed as follows:

For personal delivery:

Maricopa County Municipal Water Conservation District Number One
14825 West Grand Avenue
Surprise, Arizona 85374

For mail delivery:

Maricopa County Municipal Water Conservation District Number One
P.O. Box 900
Waddell, Arizona 85355-0900

With a copy to:

Riley Carlock & Applewhite, P.A.
Attention: Sheryl A. Sweeney, Esq.
One N. Central Avenue, Suite 1200
Phoenix, Arizona 85004-4417

or to such other address as MWD may advise AAW in writing, and to AAW at:

Arizona-American Water Company
Attn: Robert Kuta, Vice President, Service Delivery
19820 North 7th Street, Suite 201
Phoenix, Arizona 85024

With a copy to:

Gallagher & Kennedy, P.A.
Attn: Terence W. Thompson, Esq.
2575 East Camelback Road
Phoenix, Arizona 85016

or to such other address as AAW may advise MWD in writing. The designation of such person and/or address may be changed at any time by either party on written notice given under this Section. All notices, demands, requests or other communications sent pursuant to this Section will be deemed received (i) if personally delivered, on the business day of delivery, (ii) if sent by telecopy or electronic mail before noon (12:00 p.m.) Phoenix time, on the day sent if a business day or, if such day is not a business day or if sent after noon (12:00 p.m.) Phoenix time, on the next business day, (iii) if sent by overnight express carrier, on the next business day immediately following the day sent, or (iv) if sent by registered or certified mail, on the earlier of the third business day after the day sent or when actually received. Any notice by telecopy or electronic mail will be followed by delivery on the next business day by overnight express carrier or by hand.

3.4 Entire Agreement. This Agreement (including all exhibits and any other attachments) constitutes the entire understanding between the parties regarding the subject matter of this Agreement, supersedes any and all previous understandings between the parties (including any letter of intent) regarding the subject matter of this Agreement, and binds and inures to the benefit of the parties, their successors and assigns. None of the parties has entered into this Agreement in reliance upon any oral or written representation or information provided by any other party.

3.5 Further Assurances. If a party determines in its reasonable discretion that any further instruments, assurances or other things are necessary or desirable to carry out the terms of this Agreement, the other parties will execute and deliver all instruments and assurances and do all things reasonably necessary or desirable to carry out the terms of this Agreement, including using their best efforts to negotiate and enter into any agreements that may become necessary and appropriate.

3.6 No Waiver. The failure of a party to enforce at any time any of the provisions of this Agreement (or to require at any time performance by the other party of any of its provisions) is not to be construed as a waiver of such provisions and does not in any way affect the validity of this Agreement or the right of such party to enforce any provision.

3.7 Modification or Waiver. A modification or waiver of all or any part of this Agreement is not valid unless it is reduced to a written agreement.

3.8 Governing Law and Interpretation. The laws of the State of Arizona govern the interpretation and performance of this Agreement.

3.9 Severability. If any provision of this Agreement or the application thereof to any person or circumstance is held to be invalid, illegal, or unenforceable to any extent in an arbitration or court proceeding and such holding has become final and nonapplicable, the remainder of this Agreement and the application thereof will not be affected and will be enforceable to the fullest extent permitted by law.

3.10 Counterparts. This Agreement may be executed in several counterparts.

3.11 No Third Party Beneficiaries. Nothing in this Agreement, express or implied, is intended to confer any rights or remedies under or by reason of this Agreement on any persons other than the parties. Nothing in this Agreement is intended to relieve or discharge the obligation or liability of any third person to any party. This Agreement does not create any duty, liability or standard of care to any person not a party.

3.12 No Party the Drafter. This Agreement is the product of negotiation between the parties. No party is deemed the drafter of this Agreement.

3.13 Time Is of the Essence. Time is of the essence of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be entered into on the day and year first above written.

MARICOPA COUNTY MUNICIPAL WATER
CONSERVATION DISTRICT NUMBER
ONE, a municipal corporation and a political
subdivision of the State of Arizona

By: _____
Name: _____
Its: _____

ARIZONA-AMERICAN WATER COMPANY,
an Arizona corporation

By: _____
Name: _____
Its: _____

**Exhibit A
to
Interim Well-Water Supply Agreement**

Existing MWD Wells

BOS-2

5-11

6-10C

6-15

6-14

7-14C

7-22

7-23C

7-23E

11-10

5-10

ATTACHMENT B

White Tanks Regional Water Treatment Plant Detailed Capital Cost Estimate

Phase IA Detailed Estimate	
Phase IA Capacity (mgd)	13.5
Arizona American Contracted Share	7.5
	Estimated Cost
Land and Land Rights	
Land Purchase	\$ 1,350,000
Phase IA Plant Construction	
Bid Costs	
Structures and Improvements	\$ 17,986,000
Raw Water Storage Reservoirs	1,638,000
Beardsley Canal Intake	422,000
Backup Power	380,000
Pumps, Motors & Piping	1,986,000
Water Treatment Equipment	7,138,000
Finished Water Reservoir	2,151,000
Office Furniture	32,000
Tools & Equipment	40,000
Laboratory Equipment	130,000
Sub Total Bid Costs	31,903,000
Design Changes and Inflation through 5/12/05	7,000,000
Adjusted Bid Costs	38,903,000
Inflation Adjuster (6 months @ 2.5%)	488,827
Contingency @ 5%	1,945,150
Total Phase IA Plant Construction Costs	\$ 41,336,977
Phase IA Design, Construction Support, Consulting	
Original WTP Joint Venture Contract	\$ 3,294,823
Change Orders through November 2004	271,546
Delay Charges (Dec. - Feb.)	120,000
B&V Home Office Construction Support	(478,038)
Permitting through November	113,695
Estimated Additional Permitting	25,500
Prepare Bid Documents	251,440
Bidding Services	83,080
Construction Phase Services	1,189,730
Resident Engineer	594,600
AAW Internal Costs (through 12/04)	1,015,788
Estimated Additional AAW Costs	500,000
Pilot Testing DAF and UV Procurement Costs	115,000
Owners Internal Costs During Construction	500,000
Total Phase IA Design, Const. Support, Consulting	\$ 7,597,164
TOTAL Phase IA Treatment Plant Costs	\$ 48,934,141
AF Trunk Transmission Main Design and Construction	

Phase I Main	\$	9,207,970
Connection to Treatment Plant		<u>1,347,747</u>
Total Transmission Main Costs	\$	10,555,717
Interim Well Supply Costs		
Upgrade 3 existing MWD wells	\$	362,250
Connect 3 wells to Trunk Pipeline		<u>300,150</u>
Total Interim Well Supply	\$	662,400
TOTAL Phase IA Costs (before financing)	\$	61,502,258
Fair Value Financing Costs		
Construction Interest Financing (2 x 4.75%)	\$	5,842,715
Margin (0.0%)	\$	<u>-</u>
Total Capitalized Interest	\$	5,842,715
TOTAL Phase IA Costs	\$	67,344,973

Phase IB Detailed Estimate	
Phase IB Capacity (mgd)	6.5
Arizona American Contracted Share	4.0
	Estimated Cost
Phase IB Plant Construction	
Structures and Improvements	\$ 2,025,000
Water Treatment Equipment	4,050,000
Pumps Motors and Piping	675,000
Total Phase IB Plant Costs	\$ 6,750,000
Phase IB Design, Construction Support	\$ 750,000
TOTAL Phase IB Treatment Plant Costs	\$ 7,500,000
Financing Costs	
Issuance Cost	\$ -
TOTAL Phase IB Costs	\$ 7,500,000

ATTACHMENT C

White Tanks Regional Water Treatment Plant Comparison of Water Supply Options

**Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
Index to Schedules**

<u>Schedule</u>	<u>Pages</u>	<u>Description</u>
A-1	1	Summary of Annual Costs
A-2	1	Detail of Annual Costs
B-1	1	White Tanks Regional WTP - Detailed Capital Cost Estimate
B-2	1	White Tanks Regional WTP - Capital Cost Estimate by Plant Account
B-3	1	White Tanks Regional WTP - Depreciation by Plant Account
B-4	1	White Tanks Regional WTP - Operating Cost Estimate
C-1	1	Well Supply System - Capital, Depreciation and Operating Cost Estimate
C-2	1	Arsenic Treatment - Capital and Operating Cost Estimate
D-1	1	Standalone Surface WTP - Capital Cost and Depreciation Estimate by Plant Account

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
Detail of Annual Costs
Prepared by ARICOR Water Solutions
 9/12/2005

Schedule A-1

Estimated Annual Costs			
	White Tanks Regional Water Treatment Plant	Well Supply System with Arsenic Treatment	Standalone Water Treatment Plant
Annual Cost of Capital	\$ 4,798,668	\$ 5,014,094	\$ 7,813,492
Annual Operating Costs	1,319,698	3,013,404	1,524,252
Water Resource Annual Costs	1,349,997	1,174,807	1,349,997
Total Annual Costs	\$ 7,468,364	\$ 9,202,305	\$ 10,687,741
Difference From Low Cost Option	+0.0%	+23.2%	+43.1%
Annual Cost Per 1,000 gallons produced	\$ 2.22	\$ 2.74	\$ 3.18

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
Detail of Annual Costs
Prepared by ARICOR Water Solutions
9/12/2005

Schedule A-2

Annual Costs				
	Factor	White Tanks Regional Water Treatment Plant	Well Supply System with arsenic treatment	Standalone Water Treatment Plant
Capital Costs				
Assumptions:				
Debt Ratio	60.0%			
Equity Ratio	40.0%			
Cost of Debt		6.0%	6.0%	6.0%
Cost of Equity		12.0%	12.0%	12.0%
Weighted Average Cost of Debt		3.6%	3.6%	3.6%
Weighted Average Cost of Equity		4.8%	4.8%	4.8%
Federal Tax Rate	34.0000%			
State Tax Rate	6.9680%			
Combined Federal/State Tax Rate	38.5989%			
Total Capital Cost Estimate		\$ 42,029,258	\$ 37,468,170	\$ 55,933,626
Annual Cost of Capital (Year 1)				
Annual Depreciation		\$ 1,086,890	\$ 736,185	\$ 1,427,300
Return				
Debt Cost		1,513,053	1,348,854	2,013,611
Equity Cost		2,017,404	1,798,472	2,684,814
Income Tax on Equity Return	0.62863	1,268,211	1,130,582	1,687,768
Total Annual Cost of Capital		\$ 5,885,559	\$ 5,014,094	\$ 7,813,492
Operating Costs				
Assumptions:				
CAP Water Op. Cost per 1,000 gallon		\$ 0.3930		\$ 0.4323
AZ-AM Annual Average Day (MGD)	9.2			
AZ-AM Annual Usage (gallons)	3,358,000,000			
AZ-AM Annual Usage (acre-feet)	10,305			
Annual Operating Cost				
CAP Water Treatment Operating Costs		\$ 1,319,698		\$ 1,524,252
Well System Operating Costs		-	\$ 3,013,404	-
Subtotal Annual Operating Costs		1,319,698	3,013,404	1,524,252
Water Resource Annual Costs				
	<u>per acre-foot</u>			
CAP Water Purchase	\$ 106.00	1,092,364	1,092,364	1,092,364
CAP Water Wheeling	\$ 25.00	257,633		257,633
CAP Recharge Costs	\$ 8.00	-	82,443	-
Subtotal Water Resource Annual Costs		1,349,997	1,174,807	1,349,997
Total Annual Costs		\$ 8,555,254	\$ 9,202,305	\$ 10,687,741
Annual Cost Per 1,000 gallons		\$ 2.55	\$ 2.74	\$ 3.18

**Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
White Tanks Regional Water Treatment Plant
Detailed Capital Cost Estimate
Prepared by ARICOR Water Solutions
9/12/2005**

Schedule B-1

Phase IA Detailed Estimate			
Phase IA Capacity (MGD)	13.5		
Arizona American Contracted Share	55.6%	7.5	
	Estimated Cost		
Land and Land Rights			
Land Purchase	\$	1,350,000	
Phase IA Plant Construction			
Bid Costs			
Structures and Improvements	\$	17,986,000	
Raw Water Storage Reservoirs		1,638,000	
Bearsley Canal Intake		422,000	
Backup Power		380,000	
Pumps, Motors & Piping		1,986,000	
Water Treatment Equipment		7,138,000	
Finished Water Reservoir		2,151,000	
Office Furniture		32,000	
Tools & Equipment		40,000	
Laboratory Equipment		130,000	
Sub Total Bid Costs		31,903,000	
Design Changes and Inflation through 5/12/05		7,000,000	
Adjusted Bid Costs		38,903,000	
Inflation Adjuster (6 months @ 2.5%)		488,827	
Contingency @ 5%		1,945,150	
Total Phase IA Plant Construction Costs	\$	41,336,977	
Phase IA Design, Construction Support, Consulting			
Original WTP Joint Venture Contract	\$	3,294,823	
Change Orders through November 2004		271,546	
Delay Charges (Dec. - Feb.)		120,000	
B&V Home Office Construction Support		(478,038)	
Permitting through November		113,695	
Estimated Additional Permitting		25,500	
Prepare Bid Documents		251,440	
Bidding Services		83,080	
Construction Phase Services		1,189,730	
Resident Engineer		594,600	
AAW Internal Costs (through 12/04)		1,015,788	
Estimated Additional AAW Costs		500,000	
Pilot Testing DAF and UV Procurement Costs		115,000	
Owners Internal Costs During Construction		500,000	
Total Phase IA Design, Const. Support, Consulting	\$	7,597,164	
TOTAL Phase IA Treatment Plant Costs	\$	48,934,141	
TOTAL Phase IA Treatment Plant Cost per MGD capacity	\$	3,624,751	
TOTAL Phase IA Treatment Plant Cost per gallon capacity	\$	3.62	
AF Trunk Transmission Main Design and Construction			
Phase I Main	\$	9,207,970	
Connection to Treatment Plant		1,347,747	
Total Transmission Main Costs	\$	10,555,717	
Interim Well Supply Costs			
Upgrade 3 existing MWD wells	\$	362,250	
Connect 3 wells to Trunk Pipeline		300,150	
Total Interim Well Supply	\$	662,400	
TOTAL Phase IA Costs (before financing)	\$	61,502,258	
TOTAL Phase IA Cost (before financing) per MGD capacity	\$	4,555,723	
TOTAL Phase IA Cost (before financing) per gallon capacity	\$	4.56	
Fair Value Financing Costs			
Construction Interest Financing (2 x 4.75%)	\$	5,842,715	
Other	\$	-	
Total Capitalized Interest	\$	5,842,715	
TOTAL Phase IA Costs	\$	67,344,973	
TOTAL Phase IA Costs per MGD of capacity	\$	4,988,517	
TOTAL Phase IA Cost per gallon of capacity	\$	4.99	

Phase IB Detailed Estimate			
Phase IB Capacity (MGD)	6.5		
Arizona American Contracted Share	61.5%	4.0	
	Estimated Cost		
Phase IB Plant Construction			
Structures and Improvements	\$	2,025,000	
Water Treatment Equipment		4,050,000	
Pumps Motors and Piping		675,000	
Total Phase IB Plant Costs	\$	6,750,000	
Phase IB Design, Construction Support	\$	750,000	
TOTAL Phase IB Treatment Plant Costs	\$	7,500,000	
TOTAL Phase IB Treatment Plant Cost per MGD capacity	\$	1,153,846	
TOTAL Phase IIB Treatment Plant Cost per gallon capacity	\$	1.15	
Financing Costs			
Issuance Cost	\$	-	
TOTAL Phase IB Costs	\$	7,500,000	
TOTAL Phase IB Cost per MGD capacity	\$	1,153,846	
TOTAL Phase IIB Cost per gallon capacity	\$	7.50	

Phase I Summary Cost Estimate			
Phase I Capacity (mgd)	20		
Arizona American Contracted Share	11.5		
	Estimated Cost		
Land Purchase	\$	1,350,000	
Treatment Plant Costs			
Phase IA Treatment Plant Costs	\$	48,934,141	
Phase IB Treatment Plant Costs		7,500,000	
TOTAL Phase I Treatment Plant Cost	\$	56,434,141	
TOTAL Phase I Treatment Plant Cost per MDG capacity	\$	2,821,707	
TOTAL Phase I Treatment Plant Cost per gallon capacity	\$	2.82	
AF Trunk Transmission Main Design and Construction	\$	10,555,717	
Interim Well Supply Costs	\$	662,400	
TOTAL Phase I Costs (before financing)	\$	69,002,258	
TOTAL Phase I Cost (before financing) per MGD capacity	\$	3,450,113	
TOTAL Phase I Cost (before financing) per gallon capacity	\$	3.45	
Financing Costs			
Phase IA Financing Costs	\$	5,842,715	
Phase IB Financing Costs	\$	-	
Total Financing Costs	\$	5,842,715	
TOTAL Phase I Costs	\$	74,844,973	
TOTAL Phase I Costs per MGD of capacity	\$	3,742,249	
TOTAL Phase I Cost per gallon of capacity	\$	3.74	

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
White Tanks Regional Water Treatment Plant
Capital Cost Estimate by Plant Account
Prepared by ARICOR Water Solutions
9/12/2005

Schedule B-2

Phase IA - Cost Estimate by Plant Account									
	Land Purchase	Phase IA Plant Construction	Phase IA Design, Const. Support, Consulting	Transmission Main Design and Const.	Interim Well Supply	Phase IA Estimated Cost (before financing)	Financing Costs	Total Phase IA Estimated Cost	Arizona American Share Phase IA
303 Land and Land Rights	\$ 1,350,000	\$ -	\$ -	\$ -	\$ -	\$ 1,350,000	\$ -	\$ 1,350,000	\$ 750,000
304 Structures and Improvements		23,304,607	4,283,064			27,587,671	2,679,648	30,267,319	16,815,177
305 Collecting and Impounding Reservoirs		2,122,370	390,062			2,512,432	244,038	2,756,470	1,531,372
306 Lake, River and Other Intakes		546,789	100,492			647,281	62,872	710,153	394,529
307 Wells and Springs					36,225	36,225	3,519	39,744	22,080
310 Power Generation Equipment		492,369	90,491			582,860	56,614	639,474	355,263
311 Pumping Equipment		2,573,276	472,933		326,025	3,372,234	327,552	3,699,786	2,055,437
320 Water Treatment Equipment		9,248,765	1,699,795			10,948,560	1,063,456	12,012,016	6,673,342
330 Distribution Reservoirs and Standpipes		2,787,068	512,225			3,299,293	320,467	3,619,760	2,010,978
331 Transmission and Distribution Mains				10,555,717	300,150	10,855,867	1,054,453	11,910,320	6,616,844
340 Office Furniture and Equipment		41,463	7,620			49,083	4,768	53,850	29,917
343 Tools, Shop and Garage Equipment		51,828	9,525			61,354	5,959	67,313	37,396
344 Laboratory Equipment		168,442	30,957			199,399	19,368	218,767	121,537
TOTALS	\$ 1,350,000	\$ 41,336,977	\$ 7,597,164	\$ 10,555,717	\$ 662,400	\$ 61,502,258	\$ 5,842,715	\$ 67,344,973	\$ 37,413,874

Phase IB - Cost Estimate by Plant Account						
	Phase IB Plant Construction	Phase IB Design, Const. Support, Consulting	Phase IB Estimated Cost (before financing)	Financing Costs	Total Phase IB Estimated Cost	Arizona American Share Phase IB
303 Land and Land Rights	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
304 Structures and Improvements	2,025,000	225,000	2,250,000	-	2,250,000	1,384,615
305 Collecting and Impounding Reservoirs			-	-	-	-
306 Lake, River and Other Intakes			-	-	-	-
307 Wells and Springs			-	-	-	-
310 Power Generation Equipment			-	-	-	-
311 Pumping Equipment	675,000	75,000	750,000	-	750,000	461,538
320 Water Treatment Equipment	4,050,000	450,000	4,500,000	-	4,500,000	2,769,231
330 Distribution Reservoirs and Standpipes			-	-	-	-
331 Transmission and Distribution Mains			-	-	-	-
340 Office Furniture and Equipment			-	-	-	-
343 Tools, Shop and Garage Equipment			-	-	-	-
344 Laboratory Equipment			-	-	-	-
TOTALS	\$ 6,750,000	\$ 750,000	\$ 7,500,000	\$ -	\$ 7,500,000	\$ 4,615,385

Phase I - Summary Cost Estimate by Plant Account				
	Total Phase IA Estimated Cost	Phase IB Estimated Cost	Total Phase I Estimated Cost	Arizona American Share Phase I
303 Land and Land Rights	\$ 1,350,000	\$ -	\$ 1,350,000	\$ 750,000
304 Structures and Improvements	\$ 30,267,319	\$ 2,250,000	\$ 32,517,319	\$ 18,199,793
305 Collecting and Impounding Reservoirs	\$ 2,756,470	\$ -	\$ 2,756,470	\$ 1,531,372
306 Lake, River and Other Intakes	\$ 710,153	\$ -	\$ 710,153	\$ 394,529
307 Wells and Springs	\$ 39,744	\$ -	\$ 39,744	\$ 22,080
310 Power Generation Equipment	\$ 639,474	\$ -	\$ 639,474	\$ 355,263
311 Pumping Equipment	\$ 3,699,786	\$ 750,000	\$ 4,449,786	\$ 2,516,975
320 Water Treatment Equipment	\$ 12,012,016	\$ 4,500,000	\$ 16,512,016	\$ 9,442,573
330 Distribution Reservoirs and Standpipes	\$ 3,619,760	\$ -	\$ 3,619,760	\$ 2,010,978
331 Transmission and Distribution Mains	\$ 11,910,320	\$ -	\$ 11,910,320	\$ 6,616,844
340 Office Furniture and Equipment	\$ 53,850	\$ -	\$ 53,850	\$ 29,917
343 Tools, Shop and Garage Equipment	\$ 67,313	\$ -	\$ 67,313	\$ 37,396
344 Laboratory Equipment	\$ 218,767	\$ -	\$ 218,767	\$ 121,537
TOTALS	\$ 67,344,973	\$ 7,500,000	\$ 74,844,973	\$ 42,029,258

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
White Tanks Regional Water Treatment Plant
Depreciation by Plant Account
Prepared by ARICOR Water Solutions
 9/12/2005

Schedule B-3

Phase I Summary - Depreciation by Plant Account				
	Total Phase I Estimated Cost	Depreciation Rate	Annual Depreciation	Arizona American Share Phase I
303 Land and Land Rights (non depreciable)	\$ 1,350,000	n/a	\$ -	\$ -
Depreciable Assets:				
304 Structures and Improvements	32,517,319	2.50%	812,933	-
305 Collecting and Impounding Reservoirs	2,756,470	2.50%	68,912	-
306 Lake, River and Other Intakes	710,153	2.50%	17,754	-
307 Wells and Springs	39,744	2.52%	1,002	-
310 Power Generation Equipment	639,474	5.00%	31,974	-
311 Pumping Equipment	4,449,786	4.42%	196,681	-
320 Water Treatment Equipment	16,512,016	3.33%	549,850	-
330 Distribution Reservoirs and Standpipes	3,619,760	1.67%	60,450	-
331 Transmission and Distribution Mains	11,910,320	1.53%	182,228	-
340 Office Furniture and Equipment	53,850	4.55%	2,450	-
343 Tools, Shop and Garage Equipment	67,313	4.14%	2,787	-
344 Laboratory Equipment	218,767	3.71%	8,116	-
TOTAL Depreciable Assets	\$ 73,494,973	2.63%	\$ 1,935,136	\$ -

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
White Tanks Regional Water Treatment Plant
Operating Cost Estimate
Prepared by ARICOR Water Solutions
 9/12/2005

Schedule B-4

Annual Operating Cost Estimate			
Constructed Capacity	20.00	MGD	
Plant Utilization Factor	80%		
Annual Average Daily (AAD) Flow	16.00	MGD	
Annual Average Daily (AAD) Flow	5,840,000,000	gallons	
			Arizona American Cost Estimate
Fixed Costs			
Labor			\$ 644,741
Vehicle Expense			2,996
Leased Auto			25,656
Telephone and Telemetry			20,662
Misc. Expense			49,324
Safety Supplies			4,250
Misc. Contract Services			96,445
Contract Lab			39,015
Replacements			118,854
Maintenance			106,755
Total Fixed Cost			\$ 1,108,699
Variable Costs	<u>Unit Cost per 1,000 gallon</u>		
Treatment Chemicals	\$ 0.0530		\$ 309,236
UV Royalty	\$ 0.0150		87,600
Sludge Chemicals	\$ 0.0012		7,175
Sludge Hauling	\$ 0.0128		74,867
Electric Power	\$ 0.0426		248,525
Total Variable Costs			\$ 727,403
Management and Overhead Costs			
Contract Operator	15.0%		\$ 275,415
Maricopa Water District	10.0%		183,610
Total Management and Overhead Costs			\$ 459,026
Total Estimated Operating Costs			\$ 2,295,128
Total Cost per 1,000 gallons			\$ 0.3930

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
Well Supply System
Capital, Depreciation and Operating Cost Estimate
Prepared by ARICOR Water Solutions
9/12/2005

Schedule C-1

Capital Cost Estimate Well Supply System			
	Cost Estimate	Depreciation Rate	Annual Depreciation
Well Costs			
303 Land and Land Rights	\$ 10,000	n/a	\$ -
307 Wells and Springs	550,000	2.52%	13,860
310 Power Generation Equipment	55,000	5.00%	2,750
311 Pumping Equipment	440,000	4.42%	19,448
320 Water Treatment Equipment (Chlorinator)	55,000	3.33%	1,832
331 Transmission and Distribution Mains	33,000	1.53%	505
TOTAL Cost per MGD (before financing)	\$ 1,143,000	3.39%	\$ 38,394
AFUDC	40,000	3.39%	1,355
TOTAL Cost Per Well	\$ 1,183,000	3.39%	\$ 39,750
Estimated Average Well Capacity 600 gpm			
Estimated Average Well Capacity 0.864 MGD			
320 Arsenic Treatment per MGD	\$ 540,000	3.3%	\$ 17,982
AF Trunk Transmission Main Design and Construction			
331 Phase I Main	\$ 9,207,970	1.53%	\$ 140,882
AFUDC	386,700	1.53%	5,917
TOTAL Trunk Transmission Main Cost	\$ 9,594,670		\$ 146,798
Required Firm Capacity 11.50 MGD			
Gross Capacity to Firm Capacity Factor 0.80			
Required Gross Capacity 14.38 MGD			
Required Number of Wells 17			
TOTAL Cost for firm capacity 11.50 MGD	\$ 37,468,170		\$ 736,185
TOTAL Cost per MGD of firm capacity	\$ 3,258,102		
TOTAL Cost per gallon of firm capacity	\$ 3.26		

Operating Cost Estimate Well Supply System			Annual Estimate of Costs
Salaries and Wages			\$ 140,000
Employee Pensions and Benefits	25% of Salaries		35,000
Purchased Power	\$ 0.3280 per 1,000 gal		1,101,385
Chemicals (non-arsenic treatment)	\$ 0.0500 per 1,000 gal		167,900
Arsenic Treatment	\$ 0.4253 per 1,000 gal		1,428,119
Materials and Supplies	\$ 3,000 per well		51,000
Maintenance and Replacements	\$ 3,000 per well		51,000
Transportation Expense			20,000
Insurance			5,000
Taxes other than Income	10% of Salaries		14,000
Total Annual O&M Costs			\$ 3,013,404
Usage Assumptions			
Plant Utilization (% of Firm)	80%		
Annual Pumpage	3,358,000,000 gallons		
Cost of Power Assumptions			
Total Pumping Head	650 feet		
Pump/Motor efficiency	58%		
Cost per KWh	\$ 0.09		
Labor Assumptions			
1 Senior Operator			
2 Operator			
1 Laborer			

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
Arsenic Treatment Capital Cost Estimate
Prepared by ARICOR Water Solutions
9/12/2005

Schedule C-2

Estimated Arsenic Treatment Capital Costs for Agua Fria Water Plants					
Site	Capacity	Average Arsenic Concentration	Cost Estimate	Cost per gpm	Cost per MGD
AF WP#1	4,800		\$ 3,380,610	\$ 704.29	\$ 489,093
AF WP#2	3,600	10.67	\$ 2,444,748	\$ 679.10	\$ 471,595
AF WP#5	2,200	33.67	\$ 2,404,558	\$ 1,092.98	\$ 759,014
Totals	10,600	22.17	\$ 8,229,916	\$ 776.41	\$ 539,172
Use				\$	540,000

Estimated Arsenic Treatment Operating Costs					
	Projected Annual Cost				
	2006	2007	2008	2009	Average
Power	\$ 28,030	\$ 28,703	\$ 29,420	\$ 30,156	\$ 29,077
Equipment Repairs	103,732	106,222	108,877	111,599	107,608
Chemicals/Media	767,045	785,454	805,091	825,218	795,702
Sludge/Media Disposal	14,834	15,190	15,569	15,958	15,388
	\$ 913,641	\$ 935,569	\$ 958,957	\$ 982,931	\$ 947,775
Gross Annual Well Capacity 5,571,360,000					
Gross Capacity to Firm Capacity Factor 0.80					
Firm Annual Well Capacity 4,457,088,000					
Well Utilization Factor 0.50					
Annual Gallons Produced 2,228,544,000					
Cost per 1,000 Gallon Produced \$ 0.4253					

Arizona-American Water Company - Agua Fria District
Comparison of Water Supply Options
Standalone Surface Water Treatment Plant
Capital Cost and Depreciation Estimate by Plant Account
Prepared by ARICOR Water Solutions
9/12/2005

Schedule D-1

Cost Estimate Phase IA - 6.25 MGD Capacity					
	Phase IA Estimated Cost for 13.5 MGD Plant (before financing)	Percentage of Cost applicable to 6.25 MGD Plant	Total Phase IA Estimated Cost (before financing)	AFUDC	Total Phase IA Estimated Cost
303 Land and Land Rights			\$ 605,000	\$ -	\$ 605,000
304 Structures and Improvements	\$ 27,587,671	60.0%	16,552,603	1,390,419	17,943,021
305 Collecting and Impounding Reservoirs	2,512,432	62.5%	1,570,270	131,903	1,702,173
306 Lake, River and Other Intakes	647,281	75.0%	485,461	40,779	526,240
310 Power Generation Equipment	582,860	35.0%	204,001	17,136	221,137
311 Pumping Equipment	3,046,209	55.0%	1,675,415	140,735	1,816,150
320 Water Treatment Equipment	10,948,560	52.5%	5,747,994	482,831	6,230,825
330 Distribution Reservoirs and Standpipes	3,299,293	65.0%	2,144,540	180,141	2,324,682
331 Transmission and Distribution Mains	10,555,717	95.0%	10,027,931	842,346	10,870,277
340 Office Furniture and Equipment	49,083	90.0%	44,175	-	44,175
343 Tools, Shop and Garage Equipment	61,354	100.0%	61,354	-	61,354
344 Laboratory Equipment	199,399	100.0%	199,399	-	199,399
TOTAL Phase IA Cost Estimate (before financing)	\$ 59,489,858		\$ 39,318,142	\$ 3,226,290	\$ 42,544,432
AFUDC			\$ 3,226,290		
TOTAL Phase IA Cost Estimate			\$ 42,544,432		
TOTAL Phase IA Plant Cost Estimate per MDG capacity			\$ 6,807,109		
Total Phase IA Plant Cost per gallon capacity			\$ 6.81		

Cost Estimate Phase IB - 6.25 MGD Capacity Addition					
	Total Phase IA Estimated Cost (before financing)	Percentage of Cost applicable to 6.25 MGD Addition	Total Phase IB Estimated Cost (before financing)	AFUDC	Total Phase IB Estimated Cost
303 Land and Land Rights	\$ 605,000	0%	\$ -	\$ -	\$ -
304 Structures and Improvements	16,552,603	40%	6,621,041	324,431	6,945,472
305 Collecting and Impounding Reservoirs	1,570,270	0%	-	-	-
306 Lake, River and Other Intakes	485,461	0%	-	-	-
310 Power Generation Equipment	204,001	100%	204,001	9,996	213,997
311 Pumping Equipment	1,675,415	80%	1,340,332	65,676	1,406,008
320 Water Treatment Equipment	5,747,994	80%	4,598,395	225,321	4,823,716
330 Distribution Reservoirs and Standpipes	2,144,540	0%	-	-	-
331 Transmission and Distribution Mains	10,027,931	0%	-	-	-
340 Office Furniture and Equipment	44,175	0%	-	-	-
343 Tools, Shop and Garage Equipment	61,354	0%	-	-	-
344 Laboratory Equipment	199,399	0%	-	-	-
TOTAL Phase IA Cost Estimate (before financing)	\$ 39,318,142		\$ 12,763,769	\$ 625,425	\$ 13,389,194
AFUDC			\$ 625,425		
TOTAL Phase IB Cost Estimate			\$ 13,389,194		
TOTAL Phase IB Plant Cost Estimate per MDG capacity			\$ 2,142,271		
Total Phase IB Plant Cost per gallon capacity			\$ 2.14		

Cost Estimate Phase I Summary - 12.5 MGD Total Capacity				
	Total Phase I Estimated Cost	Depreciation Rate	Annual Depreciation	
303 Land and Land Rights	\$ 605,000	n/a	\$ -	
304 Structures and Improvements	24,888,493	2.50%	622,212	
305 Collecting and Impounding Reservoirs	1,702,173	2.50%	42,554	
306 Lake, River and Other Intakes	526,240	2.50%	13,156	
310 Power Generation Equipment	435,134	5.00%	21,757	
311 Pumping Equipment	3,222,158	4.42%	142,419	
320 Water Treatment Equipment	11,054,542	3.33%	368,116	
330 Distribution Reservoirs and Standpipes	2,324,682	1.67%	38,822	
331 Transmission and Distribution Mains	10,870,277	1.53%	166,315	
340 Office Furniture and Equipment	44,175	4.55%	2,010	
343 Tools, Shop and Garage Equipment	61,354	4.14%	2,540	
344 Laboratory Equipment	199,399	3.71%	7,398	
TOTAL Phase I Cost Estimate	\$ 55,933,626	2.58%	\$ 1,427,300	
TOTAL Phase I Cost Estimate per MDG capacity	\$ 4,474,690			
Total Phase I Cost per gallon capacity	\$ 4.47			

ATTACHMENT D

**White Tanks Regional Water Treatment Plant
Projected Rate Impact With Existing Hook-Up Fees**

Capital Expenditures Related to Water Hook-Up Fees

District	Brief Description of Proposed Expenditures	Prior	2005	2006	2006	2006	2007	2008	2009	2010 Post 2010	Project Total
Agua Fria Water Investment Projects											
23610203	AGUA-Cleanwtr Farms Booster St	\$4,534,316	\$3,005	\$0	\$0	\$0	\$0	\$0	\$0	-	\$4,537,320
23610401	Verrado Zone 3S Reservoir Expansion	\$0	\$61,876	\$1,561,620	\$76,500	\$124,440	\$0	\$0	\$0	-	\$1,747,936
23610501	AF WP 11 (Verrado Zone 3N BPS)	\$0	\$0	\$0	\$0	\$0	\$1,200,000	\$300,000	\$0	-	\$1,500,000
23610506	Agua Fria Well 7.3 (Corte Bella Well 3)	\$0	\$0	\$0	\$0	\$0	\$360,500	\$1,312,480	\$0	-	\$1,672,980
23610512	AF WP 9 Additional Pumps	\$0	\$90,000	\$0	\$0	\$0	\$0	\$0	\$0	-	\$90,000
23610513	AF WP 5 Expansion	\$0	\$0	\$0	\$0	\$163,200	\$1,453,536	\$0	\$0	-	\$1,616,736
23610515	Sierra Montana Plant Expansion	\$0	\$0	\$0	\$0	\$500,000	\$1,500,000	\$0	\$0	-	\$2,000,000
23610516	Corte Bella Plant Expansion	\$0	\$0	\$0	\$0	\$500,000	\$1,500,000	\$0	\$0	-	\$2,000,000
23610517	Verrado Z3N Reservoir/Z4 Booster Station	\$0	\$0	\$0	\$0	\$0	\$0	\$500,000	\$2,000,000	-	\$2,499,999
Total		\$4,534,316	\$154,880	\$1,561,620	\$76,500	\$1,287,640	\$6,014,037	\$2,112,480	\$2,000,000	-	\$17,664,972

Current Balance of Collected Hook-Up Fees \$ 5,201,978

Total Water Facilities Hook-Up Fees

	Existing HUF \$ 1,150	No Change	2004	2005	Jan - Apr 2006	May - Dec 2006	2007
Factor							
5/8-inch cust.	1.00			723	150	325	338
3/4-inch cust.	1.50			2,314	733	1,463	2,252
1-inch cust.	2.50			1,292	467	932	1,461
1.5-inch cust.	5.00			101	35	71	113
2-inch cust.	8.00			45	14	28	45
3-inch cust.	16.00			-		-	-
Customer Growth				4475	1399	2820	4209
Total Customers			21,375	25,850	27,249	30,069	34,278
5/8-inch cust.	\$1,150.00	\$1,150.00			\$ 172,077	\$ 374,320	\$ 388,700
3/4-inch cust.	\$1,725.00	\$1,725.00			\$ 1,264,073	\$ 2,524,362	\$ 3,884,700
1-inch cust.	\$2,875.00	\$2,875.00			\$ 1,342,430	\$ 2,680,840	\$ 4,200,375
1.5-inch cust.	\$5,750.00	\$5,750.00			\$ 203,573	\$ 406,537	\$ 649,750
2-inch cust.	\$9,200.00	\$9,200.00			\$ 129,058	\$ 257,729	\$ 414,000
3-inch cust.	\$18,400.00	\$18,400.00			\$ -	\$ -	\$ -
Total HUF Collections					\$ 3,111,210	\$ 6,243,787	\$ 9,537,525
Balance Forward				\$ 5,201,978	\$ 8,313,188	\$ 14,556,975	\$ 24,094,500

Existing capex program
Net Balance available for Capital Lease Offset

Company Name: ARIZONA AMERICAN WATER COMPANY
White Tanks Capital Lease Project

White Tanks Revenue Requirement:

Hook Up Fee Increase: 500

	July 2008	January 2009	January 2010	January 2011	January 2012	January 2013	January 2014	January 2015	January 2016	January 2017	January 2018
Capital Lease Plant	37,413,874	37,413,874	37,413,874	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259
Capital Lease Plant Additions	0	0	4,615,385	0	0	0	0	0	0	0	0
Land	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000
Total Depreciable Capital Lease Plant	36,663,874	36,663,874	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259
Depreciation Expense	482,845	965,690	1,067,254	1,067,254	1,067,254	1,067,254	1,067,254	1,067,254	1,067,254	1,067,254	1,067,254
Accumulated Depreciation	-	(482,845)	(1,448,535)	(2,535,789)	(3,623,043)	(4,710,298)	(5,797,552)	(6,884,807)	(7,972,061)	(9,059,315)	(10,146,570)
Total Net Capital Lease Plant	36,663,874	36,181,029	39,830,724	38,743,470	37,656,216	36,568,961	35,481,707	34,394,452	33,307,198	32,219,944	31,132,689
Hook-up Fee Contribution Offset (04/06 to 07/06)	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740	11,178,740
Amortization of Contribution	139,734	279,469	279,469	279,469	279,469	279,469	279,469	279,469	279,469	279,469	279,469
Accumulated Amortization of Hook-Up Fee Contribution	11,178,740	11,039,006	10,759,537	10,480,069	10,200,600	9,921,132	9,641,663	9,362,195	9,082,726	8,803,258	8,523,789
Net Hook-Up Fee Contribution	25,485,134	25,142,023	29,071,187	28,263,401	27,455,615	26,647,829	25,840,043	25,032,257	24,224,472	23,416,686	22,608,900
Capital Lease Plant Net of Contribution											

Net Depreciation Expense	343,111	686,221	807,786	807,786	807,786	807,786	807,786	807,786	807,786	807,786	807,786
Depreciation Expense Net of Taxes	210,675	421,349	495,992	495,992	495,992	495,992	495,992	495,992	495,992	495,992	495,992
Recoverable O&M Costs (Fixed portion of O&M Costs)	222,917	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833
Recoverable O&M Costs Net of Taxes	136,874	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748
Capital Lease Operating Income	(347,549)	(695,097)	(769,740)	(769,740)	(769,740)	(769,740)	(769,740)	(769,740)	(769,740)	(769,740)	(769,740)
Current Rate of Return	-1.36%	-2.76%	-2.65%	-2.72%	-2.80%	-2.89%	-2.98%	-3.07%	-3.18%	-3.29%	-3.40%
Required Operating Income	1,070,376	2,111,930	2,441,980	2,374,126	2,306,272	2,238,418	2,170,564	2,102,710	2,034,856	1,967,002	1,899,148
Required Rate of Return	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%
Operating Income Deficiency	1,417,924	2,807,027	3,211,719	3,143,865	3,076,011	3,008,157	2,940,303	2,872,449	2,804,595	2,736,741	2,668,887
Gross Revenue Conversion Factor	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863
Revenue Deficiency/Revenue Requirement	2,309,274	4,571,609	5,230,703	5,120,194	5,009,684	4,899,175	4,788,666	4,678,157	4,567,648	4,457,139	4,346,630

Projected Customers
Annual Per Customer
Per Month

	\$ 36,384	\$ 38,491	\$ 42,479	\$ 46,450	\$ 50,925	\$ 55,400	\$ 59,875	\$ 64,350	\$ 68,825	\$ 73,300	\$ 77,775
	\$ 63	\$ 119	\$ 123	\$ 110	\$ 98	\$ 88	\$ 80	\$ 73	\$ 66	\$ 61	\$ 56
	\$ 5.29	\$ 9.90	\$ 10.26	\$ 9.19	\$ 8.20	\$ 7.37	\$ 6.66	\$ 6.06	\$ 5.53	\$ 5.07	\$ 4.66

	January 2019	January 2020	January 2021	January 2022	January 2023	January 2024	January 2025	January 2026	January 2027	January 2028	January 2029	January 2030	January 2031	January 2032	January 2033	January 2034
\$	82,250	86,725	91,200	95,675	100,150	0	0	0	0	0	0	0	0	0	0	0
\$	52	\$ 48	\$ 44	\$ 41	\$ -	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
\$	4.29	3.96	3.67	3.40	-	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
\$	2,601,033	2,533,179	2,465,325	2,397,471	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	162,863	162,863	162,863	162,863	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	4,236,121	4,125,612	4,015,103	3,904,594	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	82,250	86,725	91,200	95,675	100,150	0	0	0	0	0	0	0	0	0	0	0
\$	52	\$ 48	\$ 44	\$ 41	\$ -	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
\$	4.29	3.96	3.67	3.40	-	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
\$	2,601,033	2,533,179	2,465,325	2,397,471	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	162,863	162,863	162,863	162,863	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	4,236,121	4,125,612	4,015,103	3,904,594	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	82,250	86,725	91,200	95,675	100,150	0	0	0	0	0	0	0	0	0	0	0
\$	52	\$ 48	\$ 44	\$ 41	\$ -	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
\$	4.29	3.96	3.67	3.40	-	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
\$	2,601,033	2,533,179	2,465,325	2,397,471	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	162,863	162,863	162,863	162,863	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483
\$	4,236,121	4,125,612	4,015,103	3,904,594	1,559,876	1,492,023	1,424,169	1,356,315	1,288,461	1,220,607	1,152,753	1,084,899	1,017,045	949,191	881,337	813,483

[illegible]

January 2051	January 2052
42,029,259	42,029,259
0	0
750,000	750,000
41,279,259	41,279,259
1,087,254	1,087,254
(46,025,965)	(47,113,220)
(4,746,706)	(5,833,961)
11,178,740	11,178,740
279,469	279,469
(11,877,411)	(12,156,880)
(688,671)	(978,140)
(4,048,035)	(4,855,821)
807,786	807,786
495,992	495,992
-	-
0.00%	0.00%
(340,035)	(407,889)
8.40%	8.40%
(340,035)	(407,889)
0	0
#DIV/0!	#DIV/0!
#DIV/0!	#DIV/0!

ATTACHMENT E

White Tanks Regional Water Treatment Plant Projected Rate Impact With Revised Hook-Up Fees

Current Balance of Collected Hook-Up Fees \$ 5,201,978

Total Proposed Hook-Up Fees

	Existing Combined HUF		New HUF		2004		2005		Jan - Apr 2006	
	Factor	1,300	Factor	1,800						
5/8-inch cust.	1.00		1.00				723		150	
3/4-inch cust.	1.50		1.50				2,314		733	
1-inch cust.	2.50		2.50				1,292		467	
1.5-inch cust.	5.00		5.00				101		35	
2-inch cust.	8.00		8.00				45		14	
3-inch cust.	16.00		16.00				-			
Customer Growth										
Total Customers					21,375		25,850	4475	1399	27,249
5/8-inch cust.	\$	1,300	\$	1,800				\$	194,522	
3/4-inch cust.	\$	1,950	\$	2,700				\$	1,428,952	
1-inch cust.	\$	3,250	\$	4,500				\$	1,517,529	
1.5-inch cust.	\$	6,500	\$	9,000				\$	230,126	
2-inch cust.	\$	10,400	\$	14,400				\$	145,891	
3-inch cust.	\$	20,800	\$	28,800				\$	-	
Total HUF Collections								\$	3,517,020	
Balance Forward							\$	5,201,978	\$	8,718,998

	May - Dec 2006	2007	Jan - Jun 2008	Jul - Dec 2008	2009	2010	2011	2012
	325	338	169	169	185	131	148	148
	1,463	2,252	1,131	1,131	2,159	2,175	2,451	2,451
	932	1,461	732	732	1,482	1,503	1,694	1,694
	71	113	55	55	116	117	132	132
	28	45	20	20	46	45	51	51
	-	-	-	-	-	-	-	-
	2820	4209	2107	2107	3988	3971	4475	4475
	30,069	34,278	36,384	38,491	42,479	46,450	50,925	55,400
\$	585,893	\$ 608,400	\$ 304,200	\$ 304,200	\$ 333,000	\$ 235,800	\$ 265,728	\$ 265,728
\$	3,951,175	\$ 6,080,400	\$ 3,052,350	\$ 3,052,350	\$ 5,829,300	\$ 5,872,500	\$ 6,617,839	\$ 6,617,839
\$	4,196,097	\$ 6,574,500	\$ 3,294,000	\$ 3,294,000	\$ 6,669,000	\$ 6,763,500	\$ 7,621,925	\$ 7,621,925
\$	636,318	\$ 1,017,000	\$ 495,000	\$ 495,000	\$ 1,044,000	\$ 1,053,000	\$ 1,186,647	\$ 1,186,647
\$	403,402	\$ 648,000	\$ 288,000	\$ 288,000	\$ 662,400	\$ 648,000	\$ 730,244	\$ 730,244
\$	-	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
\$	9,772,884	\$ 14,928,300	\$ 7,433,550	\$ 7,433,550	\$ 14,537,700	\$ 14,572,800	\$ 16,422,382	\$ 16,422,382
\$	18,491,882	\$ 33,420,182	\$ 40,853,732	\$ 40,853,732				

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<u>2022</u>	
	148
	2,451
	1,694
	132
	51
	4475
	100,150
\$	265,728
\$	6,617,839
\$	7,621,925
\$	1,186,647
\$	730,244
\$	-
\$	16,422,382

Company Name: ARIZONA AMERICAN WATER COMPANY
 White Tanks Capital Lease Project

White Tanks Revenue Requirement:

	July 2008	January 2009	January 2010	January 2011	January 2012	January 2013	January 2014	January 2015	January 2016	January 2017	January 2018
Capital Lease Plant	37,413,874	37,413,874	37,413,874	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259
Land	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000
Total Depreciable Capital Lease Plant	36,663,874	36,663,874	36,663,874	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259
Depreciation Expense	482,845	865,690	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254
Accumulated Depreciation	-	(482,845)	(1,448,535)	(2,535,789)	(3,623,043)	(4,710,298)	(5,797,552)	(6,884,807)	(7,972,061)	(9,059,315)	(10,146,570)
Total Net Capital Lease Plant	36,663,874	36,181,029	39,630,724	38,743,470	37,656,216	36,569,061	35,481,707	34,394,452	33,307,198	32,219,944	31,132,689
Hook-Up Fee Contribution Offset (04/06 to 07/08)											
Amortization of Contribution	305,384	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769
Accumulated Amortization of Hook-Up Fee Contribution		(305,384)	(916,153)	(1,526,922)	(2,137,691)	(2,748,459)	(3,359,228)	(3,969,997)	(4,580,766)	(5,191,534)	(5,802,303)
Net Hook-Up Fee Contribution	23,188,760	22,883,375	22,272,607	21,661,838	21,051,069	20,440,300	19,829,532	19,218,763	18,607,994	17,997,225	17,386,457
Capital Lease Plant Net of Contribution	13,475,114	13,297,654	17,558,118	17,081,632	16,605,146	16,128,661	15,652,175	15,175,689	14,699,204	14,222,718	13,746,232

Net Depreciation Expense	177,461	354,921	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486
Depreciation Expense Net of Taxes	108,963	217,926	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569
Recoverable O&M Costs (Fixed portion of O&M Costs)	222,917	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833
Recoverable O&M Costs Net of Taxes	136,874	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748
Capital Lease Operating Income	(245,837)	(491,674)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)
Current Rate of Return	-1.82%	-3.70%	-3.23%	-3.32%	-3.41%	-3.51%	-3.62%	-3.73%	-3.85%	-3.98%	-4.12%
Required Operating Income	565,955	1,117,003	1,474,882	1,434,857	1,394,832	1,354,808	1,314,783	1,274,758	1,234,733	1,194,708	1,154,684
Required Rate of Return	8.00%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%
Operating Income Deficiency	811,792	1,606,677	2,041,199	2,001,174	1,961,149	1,921,124	1,881,099	1,841,075	1,801,050	1,761,025	1,721,000
Gross Revenue Conversion Factor	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863
Revenue Deficiency/Revenue Requirement	1,322,109	2,619,940	3,324,357	3,259,172	3,193,986	3,128,801	3,063,615	2,998,429	2,933,244	2,868,058	2,802,873

Projected Customers	36,384	38,491	42,479	46,450	50,925	55,400	59,875	64,350	68,825	73,300	77,775
Annual Per Customer	36	68	78	70	63	56	51	47	43	39	36
Per Month	3.03	5.67	6.52	5.85	5.23	4.71	4.26	3.88	3.55	3.26	3.00

	January 2019	January 2020	January 2021	January 2022	January 2023	January 2024	January 2025	January 2026	January 2027	January 2028	January 2029	January 2030	January 2031	January 2032	January 2033	January 2034
	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259	42,029,259
	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000
	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259	41,279,259
	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254	1,087,254
	(11,233,824)	(12,321,076)	(13,408,333)	(14,495,587)	(15,582,842)	(16,670,096)	(17,757,351)	(18,844,605)	(19,931,860)	(21,019,114)	(22,106,368)	(23,193,623)	(24,280,877)	(25,368,132)	(26,455,386)	(27,542,640)
	30,045,435	28,958,180	27,870,926	26,783,672	25,696,417	24,609,163	23,521,908	22,434,654	21,347,399	20,260,145	19,172,891	18,085,636	16,998,382	15,911,127	14,823,873	13,736,619
	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760	23,188,760
	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769	610,769
	(6,413,072)	(7,023,841)	(7,634,609)	(8,245,378)	(8,856,147)	(9,466,915)	(10,077,684)	(10,688,453)	(11,299,222)	(11,909,990)	(12,520,759)	(13,131,528)	(13,742,297)	(14,353,065)	(14,963,834)	(15,574,603)
	16,775,688	16,164,919	15,554,150	14,943,382	14,332,613	13,721,844	13,111,075	12,500,307	11,889,538	11,278,769	10,668,000	10,057,232	9,446,463	8,835,694	8,224,926	7,614,157
	13,269,747	12,793,261	12,316,776	11,840,290	11,363,804	10,887,319	10,410,833	9,934,347	9,457,862	8,981,376	8,504,890	8,028,405	7,551,919	7,075,433	6,598,948	6,122,462
	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486	476,486
	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569	292,569
	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833	445,833
	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748	273,748
	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)	(566,317)
	-4.27%	-4.43%	-4.60%	-4.78%	-4.95%	-5.13%	-5.31%	-5.49%	-5.67%	-5.85%	-6.03%	-6.21%	-6.39%	-6.57%	-6.75%	-6.93%
	1,114,659	1,074,634	1,034,609	994,584	954,560	914,535	874,510	834,485	794,460	754,436	714,411	674,386	634,361	594,336	554,312	514,287
	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%
	1,680,976	1,640,951	1,600,926	1,560,901	1,520,876	1,480,851	1,440,826	1,400,801	1,360,776	1,320,751	1,280,726	1,240,701	1,200,676	1,160,651	1,120,626	1,080,601
	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863	1.62863
	2,737,687	2,672,502	2,607,316	2,542,130	2,476,944	2,411,758	2,346,572	2,281,386	2,216,200	2,151,014	2,085,828	2,020,642	1,955,456	1,890,270	1,825,084	1,759,898
	82,250	86,725	91,200	95,675	100,150	104,625	109,100	113,575	118,050	122,525	127,000	131,475	135,950	140,425	144,900	149,375
	\$ 33	\$ 31	\$ 29	\$ 27	\$ 25	\$ 23	\$ 21	\$ 19	\$ 17	\$ 15	\$ 13	\$ 11	\$ 9	\$ 7	\$ 5	\$ 3
	\$ 2.77	\$ 2.57	\$ 2.38	\$ 2.21	\$ 2.04	\$ 1.87	\$ 1.70	\$ 1.53	\$ 1.36	\$ 1.19	\$ 1.02	\$ 0.85	\$ 0.68	\$ 0.51	\$ 0.34	\$ 0.17

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January 2051	January 2052	
42,029,259	42,029,259	0
0	750,000	750,000
41,279,259	41,279,259	41,279,259
1,087,254	1,087,254	1,087,254
(46,025,965)	(47,113,220)	(47,113,220)
(4,746,706)	(5,833,961)	(5,833,961)
23,188,760	23,188,760	23,188,760
610,769	610,769	610,769
(25,957,671)	(26,568,440)	(26,568,440)
(2,766,912)	(3,379,661)	(3,379,661)
(1,977,794)	(2,454,280)	(2,454,280)
476,486	476,486	476,486
292,569	292,569	292,569
0.00%	0.00%	0.00%
(166,135)	(206,160)	(206,160)
8.40%	8.40%	8.40%
(166,135)	(206,160)	(206,160)
0	0	0
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